TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1955

No. 170

GENERAL STORES CORPORATION, PETITIONER,

vs.

MAX SHILENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS COMMITTEE AND WAGE CLAIMANTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED JUNE 22, 1955

CERTIORARI GRANTED OCTOBER 10, 1955

Memorandum Opinion, Dimock, J.

(155)

OPINION.

DIMOCK, D. J.

On October 18, 1954, General Stores Corporation, the Debtor, filed a petition in this court under section 322 of the Bankruptcy Act, 11 U. S. C. § 722, proposing an arrangement under Chapter XI of the Act. A stockholder, Max Shlensky, has moved by order to show cause under section 328 of the Act, 11 U. S. C. § 728, for a dismissal of the proceedings unless the petition be amended so as to comply with Chapter X. The Securities and Exchange Commission has moved for leave to intervene and to support a motion which it has filed for the same relief as asked by the stockholder.

The motion of the Securities and Exchange Commission for leave to intervene is granted. Its motion for dismissal of the proceedings unless the petition be amended so as to comply with Chapter X will be considered with that of the stockholder.

The factors which should control the decision of the question have been discussed by the Supreme Court in Securities Comm'n. v. U. S. Realty Co., 310 U. S. 434. There the court stated, page 447, that "the two chapters were specifically devised to afford different procedure, the one adapted to the reorganization of corporations with complicated debt structures and many stockholders, the other to composition of debts of small individual business and corporations with few stockholders". In that case proceedings (156) under Chapter XI were dismissed. The debtor there had outstanding 900,000 shares of stock listed on the New York Stock Exchange and held by 7,000 stockholders. Its assets were listed at about $7,000,000 and its liabilities at about $5,000,000.

In a more recent case the Court of Appeals for this Circuit has declined to interfere with a refusal by the district court to order that proceedings under Chapter XI

be redirected under Chapter X. Matter of Transvision, Inc., —— F. 2d ——. In the Transvision case the debtor had outstanding 385,000 shares of common stock and 1773½ shares of preferred. All were in the hands of management interests except 135,000 shares of common held by 425 investors. It was not listed on any exchange. The debtor's liabilities were about $700,000 and its assets about $1,000,000.

In the instant case the Debtor has outstanding 2,232,429 shares of common stock listed on the American Stock Exchange and held by 7,000 stockholders. It is in part listed with the Securities and Exchange Commission pursuant to the Securities Act of 1933. The Debtor's liabilities are listed at about $4,000,000 and its assets at about $5,000,000.

The proposed arrangement would have compulsory effect only on the unsecured creditors who are entitled to no priority. They would receive 100% of their claims, 20% on confirmation of the plan and 20% annually thereafter.

The Debtor, now known as General Stores Corporation, (157) was formerly D. A. Schulte, Inc. The stock was in part issued pursuant to a plan of reorganization pursuant to section 77B of the Bankruptcy Act which was consummated as of October 31, 1950. The balance was later sold by the debtor at prices ranging from $1.375 to $1.60 per share.

The Debtor was organized in 1915 and throughout most of its history operated a chain of stores for the sale of tobacco and accessory products as well as other sundry items. After the 77B reorganization proceeding and during the war years the Debtor enjoyed a profitable operation due principally to wartime scarcities. In the post-war period, however, the Debtor's volume began to fall. In addition, the Debtor's profit margin, already low with respect to most of its products, became narrower as prices declined and costs rose. Attempts at modernization of existing units failed materially to stem continuing losses.

A sale of the 400,000 shares of common stock in 1951 was accompanied by a change in the management of the enterprise. It was announced at that time that the $600,000 proceeds of the stock sale would be used to convert a number of the existing units to candy or food and drink operations in order to improve profit margins and thus reduce the company's losses. After consummation of the stock sale, however, further studies of the program were made and, upon discovery, that costs of conversion would be too great, the program was abandoned and the proceeds of the sale were used for general corporate purposes. (158) During the four years and five months ended March 31, 1953, the Debtor sustained aggregate losses exceeding $2,700,000. With the continuance of losses in 1953 and 1954[1] the Debtor embarked upon a program of discontinuing the operation of its Schulte-type stores.[2]

In August 1953, the Debtor purchased all of the outstanding capital stock of Stineway Drug Company. Stineway operates a chain of 23 retail stores in the Chicago area engaged in selling drugs, cosmetics, tobacco products, drug sundries, candy and liquor; all but one of the stores also operate fountains and luncheonettes. In addition, Stineway operates a public cafeteria and sells merchandise to 12 independent stores in the Chicago area known as Stineway System Stores. The purchase price of this stock was $1,220,320.50, $800,000 of which was paid by the Debtor at the closing and the balance was to be paid on April 15, 1954. Of the $800,000 down payment $365,000 was ultimately borrowed by the Debtor from Stineway; according to the company's latest prospectus, the Debtor borrowed an aggregate of $870,000 from Stineway to pay part of the purchase price.

[1] For the five years and five months ended March 31, 1954 the Debtor sustained losses exceeding $4,200,000.

[2] At July 21, 1954, 46 such stores were in operation.

Memorandum Opinion, Dimock, J.

Early in 1954 the Debtor contracted to purchase all the capital stock of Ford Hopkins Company. Ford Hopkins is engaged in the operation of a chain of 48 drug stores and three (159) restaurants principally in Chicago as well as elsewhere in Illinois and in Indiana, Iowa and Wisconsin. Ford Hopkins also owns all the stock of Sargent's Drug Store, the operator of five stores in the Chicago area, and supplies approximately 700 grocery chain stores with standard cosmetic items.

The purchase price of the Ford Hopkins stock was $2,800,000, payable $735,000 upon consummation and the balance over a period of years, at 4% interest. The down payment of $735,000 was derived from (1) the proceeds of the sale of 178,500 shares of common stock in May 1954: $245,438; (2) the proceeds of loans, including one from the Debtor's president: $55,000; and (3) the proceeds of a loan from Stineway: $440,000.[3]

To secure the balance of the purchase price, $2,065,000, the Debtor transferred the following collateral to a Trustee: (1) all of the capital stock of Ford Hopkins and Stineway; (2) dividends payable upon Ford Hopkins and Stineway stock; (3) life insurance policies aggregating $1,700,000 upon the life of the Trustee (one of the sellers); (4) the Debtor's rights to commissions payable to it by Ford Hopkins and Stineway under service contracts based generally upon 1% of the respective net sales of Ford Hopkins and Stineway.

After the consummation of the Ford Hopkins purchase, (160) the indebtedness of the Debtor to Stineway was represented by two non-interest bearing notes, in the amount of $225,000 payable December 15, 1954 and in the amount of $1,085,000 payable June 1, 1964.

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[3] Stineway derived this cash from the sale of warehouse inventory to Ford Hopkins. Ford Hopkins in turn was required to borrow $400,000 from a bank in order to pay for the inventory.

Memorandum Opinion, Dimock, J.

In a Chapter X proceeding the Securities and Exchange Commission would have, among others, the following rights, powers, privileges and duties:

A. Section 172, 11 U. S. C. § 572, provides that any plan of reorganization which the judge regards as worthy of consideration must be submitted to the Commission for an advisory report where the scheduled indebtedness of the debtor exceeds $3,000,000.

B. Section 175, 11 U. S. C. § 575, requires that the report of the Commission, if any, filed in the proceedings, or a summary of the report prepared by the Commission, be transmitted to all creditors and stockholders affected by the plan.

C. Section 208, 11 U. S. C. § 608, provides that the Commission must, if requested by the judge, and may, upon its own motion if approved by the judge, file a notice of its appearance in any Chapter X proceeding. It further provides that upon the filing of such notice of appearance, the Commission shall be deemed to be a party in interest, with the right to be heard on all matters arising in the proceeding, and shall be deemed to have intervened in respect of all matters in the proceeding with the same force and effect as if a petition for that purpose (161) had been allowed by the judge, with the exception that the Commission may not appeal or file any petition for appeal in the proceeding.

D. Section 265, 11 U. S. C. § 665, provides that the Commission shall be given notice of all steps taken in connection with any proceeding, and that there shall be transmitted to the Commission copies of prescribed papers filed in the proceeding and of such other papers as the Commission may request or the Court may direct be transmitted to it.

Memorandum Opinion, Dimock, J.

The Securities and Exchange Commission says that thus Chapter X, unlike Chapter XI, provides adequate means for a disinterested analysis of the Debtor's financial condition and the desirability of the continuance of the enterprise as presently constituted or on any other basis, in order to provide the Court, the parties and the creditors and stockholders with a basis for the exercise of an informed judgment as to the fairness and feasibility of reorganization proposals.

I do not think that the stockholders and creditors ought to be left to do this for themselves as they would have to in a Chapter XI proceeding. One of the strongest reasons for creating a body with the powers of the Securities and Exchange Commission was the propensity of those who had a stake in an enterprise to follow blindly the proposals of management.

In the case of Transvision, Inc., with its 475 outside investors, Judge Sugarman exercised his discretion in favor of (162) proceeding under Chapter XI and the Court of Appeals upheld him. I do not feel, however, that the action of the Court of Appeals constrains me to leave this enterprise to treatment adopted in the words of the Supreme Court in the U. S. Realty case, "to composition of debts of small individual business and corporations with few stockholders". It would require a much more complete demonstration than is possible at the threshold of a proceeding to convince me that supervision was unnecessary over the reorganization of a corporation with 7,000 holders of two and a quarter million shares of stock listed on the American Stock Exchange and recently selling at under two dollars a share.

The motion to dismiss unless the Debtor proceeds under Chapter X is granted.

Settle order on notice.

January 24, 1955.

E. J. Dimock,
United States District Judge.

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Exhibit A Annexed to Petition in Proceedings Under Chapter XI.

"General Stores Corporation," Debtor, proposes the following arrangement with its unsecured creditors:

A. Priority Creditors.

All creditors entitled to priority shall be paid in full in accordance with terms that may be arranged between the Debtor and the said priority creditors.

B. Other Unsecured Creditors.

The Debtor proposes that the rights of the other unsecured creditors be modified so as to provide for the payment to that class of creditors of a sum equal to 100% of their respective claims payable 20% upon confirmation of the plan and 20% annually thereafter.

C. Administration Expenses.

All administration expenses and allowances shall be paid in cash by Debtor upon confirmation of the plan or in accordance with terms that may be arranged between the Debtor and the persons to whom said expenses shall be payable.

Dated: New York, New York, October 18, 1954.

GENERAL STORES CORPORATION,

By John W. Coombs,
Vice-President.

Docket Entries.

A

Date	Proceedings
Oct. 18 1954	Filed petition, proposed arrangement, list of creditors, summary of assets and liabilities, etc.—c.s.
Oct. 18 1954	Filed list of ten largest creditors.
Oct. 18 1954	Filed order referring proceedings to Joyce.
Oct. 18 1954	Filed affdt. & order extending time to file schedules, statement of affairs and all other required information to ten days from date of entry hereof—Clancy, J.
Oct. 28 1954	Filed schedules and statement of affairs—c.s.
Oct. 28 1954	Filed affdt. of John W. Combs under Rule XI-2.
Nov. 1 1954	Filed petition and referee's order amending debtor's schedule A-3.
Nov. 10 1954	Filed pet. & show cause order to dismiss Chapter XI proceedings, etc.—Ret. 11/12/54.
Nov. 12 1954	Filed statement of executory contracts—c.s.
Dec. 3 1954	Receiver registered letter #3190 containing claim of Robert L. Eby and dlvd. to Referee.
Jan. 11 1955	Filed referee's certificate pursuant to Rule XI-10.
Jan. 14 1955	Filed copy of claim of City of Pontiax, County of Oakland, State of Michigan for $63.80—dlvd. to referee.
Jan. 25 1955	Filed affdt. & notice of motion of Securities & Exchange Commission to intervene to dismiss petition, refuse confirmation, etc.—(see opinion).
Jan. 25 1955	Filed affdt. of Leon Singer in opposition to motion to dismiss.

Exhibit A Annexed to Petition in Proceedings Under Chapter XI

GENERAL STORES CORPORATION

Summary of Assets and Liabilities

(For the purpose of the following summary, the items are taken as at *AUGUST 31, 1954*, that being the last date at which complete figures are available. By reason of the extensive operations of the Debtor, its books for the fiscal period ending October 2, 1954, have not as yet been closed.)

ASSETS:

Cash on hand, in banks and in transit			$ 104,831.00
Accounts and interest receivable (net)			29,000.00
Notes Receivable			57,000.00
Merchandise Inventories (cost)		Est.	625,000.00
Furniture, fixtures and equipment (net)			177,565.00
Leasehold improvements (net)			82,082.00
Investment in Stireway Drug Co.	$1,254,045.00		
Investment in Ford Hopkins Co.	2,892,688.00		
	4,146,733.00		
Less pledge to secure payment of	2,065,000.00		
Net			2,081,733.00
Various deferred charges consisting of unexpired insurance, prepaid rents, taxes, supplies and miscellaneous			96,918.00
TOTAL ASSETS			$3,254,529.00

LIABILITIES:

Accounts payable—trade	284,140.00
Accrued expenses	251,004.00
Notes payable	1,310,000.00
Tenants' deposits (unsegregated)	4,750.00
TOTAL LIABILITIES	$1,849,894.00

Order of Reference in Proceedings Under Chapter XI.

(20)

WHEREAS, a petition has been filed by the above named debtor in this Court, on the 18th day of October, 1954; for relief under Chapter XI of the Bankruptcy Act, it is Ordered that the said matter be referred to John E. Joyce, Esq., one of the Referees in Bankruptcy of this Court, to take such further proceedings therein as are required and permitted by said Act; and that the said debtor shall attend before said Referee and submit to such orders as may be made by him or by a Judge of this Court relating to said proceedings.

Dated: New York, N. Y., October 18, 1954.

JOHN W. CLANCY,
U. S. D. J.

Certificate of Referee Pursuant to Rule XI-10.

(124)

I do hereby certify the pertinent facts relating to the above arrangement proceedings:

1. Referred October 18, 1954.

2. November 8, 1954. Mailed notice of initial meeting.

3. November 23, 1954. Initial meeting held and adjourned, and further adjourned from time to time, and now set for January 18, 1955.

JOHN E. JOYCE,
Referee in Bankruptcy.

Dated, New York, January 11, 1955.

Docket Entries.

Date	Proceedings
Jan. 25 1955	Filed affdt. of N. Clarkson Earl, Jr. for denial of motion to dismiss.
Jan. 25 1955	Filed Opinion #21658 granting motion to dismiss unless debtor proceeds under Chapter X—Dimock, J.
Feb. 7 1955	Filed notice of motion and statement for reargument for motion heard and decided by opinion filed 1/25/55, etc.—Ret. 2/15/55 in Room 506.
Feb. 24 1955	Memorandum endorsed on notice of motion for reargument filed 2/7/55 denying motion—Settle order on original motion March 1, 1955 at 10:30 A. M.—Dimock, J.
Feb. 24 1955	Filed Exh. & affdt. of C. Edward Brown in support of motion for reargument.
Mar. 7 1955	Filed petition and unsigned order by Otterbourg, Steindler etc.
Mar. 4 1955	Filed notice of appeal of debtor from order of Dimock, J. dismissing proceedings under Chap. XI.—c. sent.
Mar. 4 1955	Filed cost bond—$250.—Nat'l Surety Co. to parties listed in n. a. 3/7/55.
Mar. 7 1955	Filed order dismissing Chapter XI proceeding unless debtor file an amended petition to comply with requirements of Chap. X on or before 3/15/55—Dimock, J.—signed 2/4/55.
Mar. 7 1955	Filed notice of appeal of above order—c.s. Fred. T. Finnegan; Reich, Peller, Guadagno & Caine; and Blumberg, Singer, Heppon & Blumenthal.
Mar. 7 1955	Filed cost bond on appeal—$250—Nat'l. Surety Co.

Order to Show Cause to Dismiss Proceedings Under Chapter XI.

(114)

Upon the annexed petition of Max Seidensky, verified the 28th day of October, 1954, praying for various relief,

Let, General Stores Corporation, Debtor, and Securities and Exchange Commission show cause before me the undersigned Judge or such other Judge as may be sitting in Bankruptcy Part On the 12th day of November, 1954, in Room 506 of the United States Courthouse, Foley Square, New York, at 10:00 o'clock in the forenoon of that day, or as soon thereafter as counsel can be heard, why an order should not be entered dismissing the proceedings under Chapter XI unless within such time as the Court shall fix, the petition be amended to comply with the requirements of Chapter XI for the filing of a debtor's petition or a creditor's petition under such Chapter;

Let service of a copy of this order, together with the petition upon which it is based, be made upon General Stores Corporation by service upon its attorneys, Otterbourg, Steindler, Houston & Rosen, and upon the Securities and Exchange Commission, by its counsel located in the City of New York, on or before the 10th day of November, 1954, which service shall be deemed sufficient.

Dated: New York, N. Y., November 9th, 1954.

Sylvester J. Ryan,
U. S. D. J.

Order Appealed From.

(203)

UNITED STATES DISTRICT COURT,

SOUTHERN DISTRICT OF NEW YORK.

No. 90594.

IN THE MATTER

of

Proceedings for an arrangement under Chapter XI of the Bankruptcy Act of

GENERAL STORES CORPORATION,

Debtor.

At New York, New York, in said District, on the 4th day of February, 1955.

The debtor above named, having filed a petition under Section 322, Chapter XI of the Bankruptcy Act, and a motion having been made by Max Shlensky, a stockholder of the debtor, by order to show cause dated November 9th, 1954, pursuant to Section 328 of the Bankruptcy Act, for an order dismissing the proceedings filed by General Stores Corporation, the debtor, unless within such time as this Court shall fix, the debtor's petition is amended to comply with the requirements of Chapter X for the filing of a debtor's petition or a creditor's petition under such Chapter is filed, and due notice having been given thereof, and the Securities and Exchange Commission having moved this Court for leave to intervene in the said Chapter XI proceeding for the purpose of moving this Court (a) to dismiss the debtor's petition herein, (b) to refuse confirmation of the debtor's arrangement, and (c) to dismiss the

said Chapter XI proceeding unless the debtor's petition be amended or creditor's petition be filed to conform with the provisions of Chapter X, and the Securities and Exchange Commission having also moved this Court for an order dismissing the debtor's petition for relief under Chapter XI of the Bankruptcy Act as amended, and (204) dismissing this proceeding unless the petition be amended to comply with the requirements of Chapter X for the filing of debtor's petition or a creditor's petition under Chapter X be filed, and all motions having duly come on to be heard before this Court on the 2nd day of December, 1954, and Reich, Peller, Guadagno & Caine, Esqs., by A. Alan Reich, of counsel, attorneys for Max Shlensky, appearing and having been heard in support of said motion of Max Shlensky, and George Zolotar, Esq., attorney for the Securities and Exchange Commission, appearing and having been heard in support of the motions of the Securities and Exchange Commission, and Otterbourg, Steindler, Houston & Rosen, Esqs., by Frederic P. Houston of counsel, attorneys for General Stores Corporation, the debtor, appearing and having been heard in opposition to all motions, and Blumberg, Singer, Heppen & Blumenthal, Esqs., attorneys for a creditors' committee therein, having appeared in opposition to all motions, and the Court having filed its opinion dated January 24th, 1955,

Now, upon the order to show cause, signed by the Hon. Sylvester J. Ryan, a Judge of this Court, on the 9th day of November, 1954, and the petition annexed thereto of Max Shlensky, verified the 28th day of October, 1954, submitted in support of the motion of Max Shlensky; the affidavit of N. Clarkson Earl, Jr., sworn to the 26th day of November, 1954, submitted in opposition to the motion of Max Shlensky; the motion for leave to intervene by the Securities and Exchange Commission, dated the 1st day of December, 1954, verified by George Zolotar, Esq., the 1st

Order Appealed From

day of December, 1954, and the motion to dismiss made by the Securities and Exchange Commission dated the 1st day of December, 1954, and the affidavit in support of said motion duly sworn to the 1st day of December, 1954, and the opinion of the Hon. Edward J. Dimock, filed on the 24th day of January, 1955, and it is

(205) ORDERED:

1. The motion by the Securities and Exchange Commission for leave to intervene in this proceeding for the purpose of moving to dismiss the debtor's petition herein to deny confirmation of the proposed Chapter XI proceeding, and to dismiss the arrangement herein, be and the same hereby is granted;

2. The petition of General Stores Corporation for relief under Chapter XI of the Bankruptcy Act and the proceedings under Chapter XI, be and they hereby are dismissed unless on or before March 15, 1955, General Stores Corporation file an amended petition to comply with the requirements of Chapter X for the filing of a debtor's petition or unless on or before such date a creditors' petition under Chapter X be filed.

EDWARD J. DIMOCK,
U. S. D. J.

18. That it would be for the best interests of the stockholders that a trustee be appointed pursuant to the provisions of Chapter X to go forward and develop a plan of reorganization which would be in the best interests of the stockholders in addition to those of general creditors.

(119) 19. That pursuant to decisions of the various Courts, including the Supreme Court of the United States, this matter is improperly brought under Chapter XI.

WHEREFORE, your petitioner respectfully prays that the annexed Order to Show Cause be signed directing the debtor and the Securities and Exchange Commission, or any other party in interest which the Court may designate, to show cause why the order should not be entered dismissing the proceedings under Chapter XI unless within such time as the Court shall fix, the petition be amended to comply with the requirements of Chapter XI for the filing of a debtor's petition or a creditor's petition under such Chapter. For all of which relief no previous application has been made.

Dated: New York, N. Y., October 26, 1954.

MAX SHLENSKY,
Petitioner.

(Verified by Max Shlensky on October 28, 1954.)

Motion for Leave to Intervene by Securities and Exchange Commission.

(125)

Upon all the proceedings heretofore had herein, the Securities and Exchange Commission, by George Zolotar, its attorney, moves for leave to intervene in this proceeding for the purpose of moving this Court on the grounds stated in the motion to dismiss annexed hereto and submitted herewith:

(a) to dismiss the Debtor's petition herein;

(b) to refuse confirmation of the Debtor's arrangement; and

(c) to dismiss this proceeding unless the Debtor's petition be amended, or creditors' petition be filed, to conform to the provisions of Chapter X.

The motion for intervention is based upon the following allegations upon information and belief:

I

On October 18, 1954, the Debtor filed a petition under Section 322 of the Bankruptcy Act, proposing an arrangement under Chapter XI of the Act. By Order to Show Cause, dated November 9, 1954, on the petition of Max Shlensky, a stockholder of the Debtor, verified October 28, 1954, the Debtor and the Securities and (126) Exchange Commission were directed to show cause why an order should not be entered dismissing the proceedings under Chapter XI unless the petition be amended to comply with the requirements of Chapter X for the filing of a debtor's or creditors' petition under such chapter.

Memorandum Denying Motion for Reargument, Dimock, J.

(185a)

Motion denied. Settle order on original motion March 1, 1955, 10:30 A. M.

February 24, 1955.

E. J. DIMOCK,
U. S. D. J.

Petition in Proceedings Under Chapter XI.

(1)

TO THE HONORABLE JUDGE OF THE
UNITED STATES DISTRICT COURT FOR
THE SOUTHERN DISTRICT OF NEW YORK:

The petition of General Stores Corporation, a corporation engaged in the business of selling at retail, tobacco, tobacco products, smokers' accessories and various items of men's and women's wearing apparel, respectfully represents:

1. Your petitioner has not been known by any other name or trade name for the past six years except that prior to February 15, 1954, your petitioner was known by the name of D. A. Schulte, Inc.; that on said 15th day of February, 1954, there was filed in the Office of the Secretary of State of the State of New York, a certificate changing the name of your petitioner from D. A. Schulte, Inc. to General Stores Corporation.

2. Your petitioner is a business corporation organized and existing under the laws of the State of New York and has been and still is domiciled in the State of New York, Southern District of New York, and has its principal place of business at 380 Broadway, in the Borough

Memorandum Denying Motion for Reargument.
Dimock, J.

of Manhattan, City and State of New York, said has its principal place of business in the Borough of Manhattan, City and State of New York within the said judicial district for a longer portion of the six months immediately preceding the filing of this petition than in any other judicial district.

3. No bankruptcy proceeding, initiated by a petition by or against your petitioner, is now pending.

4. Your petitioner is unable to pay its debts as they mature, and proposes the arrangement with its unsecured creditors (2) as set forth in Exhibit A hereto annexed and made part hereof.

5. With this petition, petitioner files a list of its creditors and their addresses and a summary of its assets and liabilities in accordance with Section 324(1) of the Bankruptcy Act and is simultaneously applying to the court for an order granting petitioner further time, not exceeding ten (10) days, for the filing of the statement of executory contracts and the schedules and statement of affairs, all in accordance with Section 324(1) of the said Act.

WHEREFORE, your petitioner prays that upon this petition, proceedings may be had in accordance with the provisions of Chapter XI of the Act of Congress relating to bankruptcy.

GENERAL STORES CORPORATION,

By JOHN W. COMBS,
Vice-President.

OTTERBOURG, STEINDLER, HOUSTON & ROSEN,
Attorneys for Debtor,

By MARKS F. PASKE,
Partner.

Petition.

(115)

The petition of M. Shlensky respectfully shows this Court and alleges:

1. That your petitioner has his place of business at 190 West Monroe Street, City of Chicago, State of Illinois, and is the owner of three thousand (3,000) shares of the common stock of the above named debtor, having acquired said stock within a period of approximately three (3) years preceding the filing of a petition for arrangement herein and all of said stock having been acquired by him more than one (1) year from the date of the filing of said petition.

2. That on October 18, 1954, the debtor filed a petition for an arrangement with the Clerk of this Court alleging that it is engaged in the sale of tobacco, smokers' supplies and men's and women's apparel, having its principal place of business at 380 Broadway. No schedules were filed with said petition.

3. That said debtor formerly was known as D. A. Schulte, Inc. until February 15, 1954 at which time the name of said corporation was changed to the present name.

4. Debtor listed assets of $3,254,529.00 which consisted of the following items:

(116) ASSETS:

Cash on Hand	$ 104,831.00
Accounts Receivable	29,000.00
Notes Receivable	57,000.00
Merchandise Inventory (Cost)	625,000.00
Furniture, Fixtures & Equipment	177,965.00
Leasehold Improvements	82,082.00
Investments—Stineway Drug & Ford Hopkins	2,081,733.00
Insurance, Rents, Taxes, etc.	96,918.00
TOTAL ASSETS	$3,254,529.00

The debtor also listed liabilities of $1,649,894.00 which was composed of the following items:

LIABILITIES:

Accounts Payable	$ 284,140.00
Acc. Exp.	251,304.00
Notes Payable	1,310,000.00
Tenants' Deposits	4,750.00
TOTAL LIABILITIES	$1,649,894.00

5. That the arrangement proposed by this debtor provided for payment to unsecured creditors of 20% on confirmation and 20%, annually, thereafter until the full amount of their claims are paid.

6. Upon information and belief, debtor has also expressed a desire to discontinue operation of the Schulte type stores and to ultimately confine its operations to the chain drug field.

7. That as of March 31, 1954, the following balance sheet was issued by the debtor showing a surplus of assets over liabilities, excluding capital stock of $872,954.00. The balance sheet is as follows:

(117) ASSETS:

Cash	$ 412,445
Receivables	24,782
Inventory	1,431,814
TOTAL CURRENT ASSETS	$1,868,811
Leasehold Improvements (Net)	116,988
Fixed Assets	227,732
Leaseholds & Trademarks	2
Dividend Stineway	1,254,045
Inv. & Adv. to Schulco Co., Inc.	1
Deferred Charges	103,714
TOTAL ASSETS	$3,571,293

LIABILITIES:

Due Stineway Drugs Co..	$ 312,778
Due former stockholders of Stineway (since paid)	— 420,321
Accounts Payable	808,017
Accrued Expenses	50,172
Accrued Taxes	64,487
Other Current Liabilities & Accruals	99,372
TOTAL CURRENT LIABILITIES	$1,755,147
Due Steinway	282,500
Tenants' Deposits	5,690
Reserve for Expected Losses and Expense on Elimination of Schulte-type stores	655,000
Common Stock	2,053,922
Capital Surplus	1,355,512
Earned Surplus Deficit	2,536,478
TOTAL LIABILITIES	$3,571,293

8. That this debtor had common stock of $2,053,922; capital surplus of $1,355,512; and surplus deficit of $2,536,478. It is apparent that the principal assets of the debtor consisted of investments in Stineway Drug Co. and Ford Hopkins Co.

9. That the Stineway Drug Company, Inc., upon information and belief, was incorporated in 1937 under the Delaware laws and operates a chain of nineteen (19) drug stores and one cafeteria, all located in Chicago, Illinois.

10. That upon information and belief, the Ford Hopkins Company, Inc. was incorporated under the Delaware laws in July, 1930 and operates a chain of forty-eight (48) (118) drug stores principally in Chicago, Illinois.

11. Upon information and belief, both the capital stock of Stineway Drug Company, Inc. and Ford Hopkins Company, Inc. were purchased by this debtor within the past year when the financial condition of said debtor was exceedingly tight.

12. That substantial losses have been sustained during recent years to the detriment of stockholders.

13. That this corporation was organized under the laws of the State of New York in 1915 and filed a petition for reorganization under Section 77b of the Bankruptcy Act in 1936 and a plan of arrangement consummated in 1940.

14. That upon information and belief, the authorized capital stock of this corporation was 2,315,000 shares of common stock at $1.00 par value and subsequent to October 31, 1953, was increased to 3,000,000 shares. There is presently outstanding, upon information and belief, 2,053,922 shares.

15. That said stock of the corporation has been and is being actively traded on the American Stock Exchange.

16. That in view of the complicated operations of this debtor, including its capital structure, and the fact that the stock is being traded amongst the public, it is important that a complete and full investigation of the activities of this corporation be conducted by a responsible governmental body as well as by a designee of the Court.

17. That in view of the acquisition of the two subsidiaries previously referred to the funded obligation running into considerable amounts has been created in favor of the two subsidiaries.

Motion for Leave to Intervene by Securities and Exchange Commission.

II

The Debtor, a New York corporation, has outstanding in the hands of the public 2,232,422 shares of $1 Par Value common stock. The stock is listed upon the American Stock Exchange.

Incorporated herein by reference with the same effect as if fully set forth herein is the affidavit of George Zolotar, verified December 1, 1954, annexed to the Commission's Motion to Dismiss filed herewith.

III

The Securities and Exchange Commission (the Commission) is an agency of the United States, created pursuant to Sec. 4(a) of the Securities and Exchange Act of 1934, as amended. Under the provisions of the Bankruptcy Act of 1898, as amended, the Commission is charged with certain duties and vested with certain rights, powers and privileges for the purpose of enabling it to protect and represent investors and the general public in connection with the reorganization of corporations under Chapter X of that Act. These include the duty to maintain and preserve the public policy expressed in the Bankruptcy Act, as amended, and to forestall the impairment of its functions under Chapter X by improper resort to Chapter XI proceedings.

IV

Among the rights, powers, privileges and duties of the Commission under Chapter X of the Bankruptcy Act, as amended, are the following:

Motion for Leave to Intervene by Securities and Exchange Commission.

(127) A. Section 172 provides that any plan of reorganization which the judge regards as worthy of consideration must be submitted to the Commission for an advisory report where the scheduled indebtedness of the debtor exceeds $3,000,000.

B. Section 175 requires that the report of the Commission, if any, filed in the proceedings, or a summary of the report prepared by the Commission, be transmitted to all creditors and stockholders affected by the plan.

C. Section 208 provides that the Commission must, if requested by the judge, and may, upon its own motion if approved by the judge, file a notice of its appearance in any Chapter X proceeding. It further provides that upon the filing of such notice of appearance, the Commission shall be deemed to be a party in interest, with the right to be heard on all matters arising in the proceeding, and shall be deemed to have intervened in respect of all matters in the proceeding with the same force and effect as if a petition for that purpose had been allowed by the judge, with the exception that the Commission may not appeal or file any petition for appeal in the proceeding.

D. Section 265 provides that the Commission shall be given notice of all steps taken in connection with any proceeding, and that there shall be transmitted to the Commission copies of prescribed papers filed in the proceeding and of such other papers as the Commission may request or the Court may direct be transmitted to it.

V

The Commission represents that the petition of the Debtor has been improperly filed under Chapter XI of the Bankruptcy Act, on the grounds that Chapter XI is not

available for a corporation with publicly held securities, and that if such a corporation desires (128) to adjust its obligations under the provisions of the Bankruptcy Act, it must seek relief under Chapter X of that Act.

VI

The Commission further represents that the proposed arrangement fails to comply with Section 366 of the Bankruptcy Act in that its proposal under Chapter XI is not in good faith, and that the proposed arrangement should not receive the confirmation of this Court.

VII

If the proposed arrangement is confirmed and the proceedings are not dismissed, the interests of investors in this proceeding will be improperly affected. The Commission will be denied the rights, powers and privileges conferred on it by Chapter X and it will be prevented from performing its duties under that Chapter.

VIII

The Commission's interests and the interests of the investing public, as aforesaid, are not represented by any party to this proceeding. The financial history and condition of this Debtor demonstrate the need for such representation. The adequate representation of these interests requires that the Commission be permitted to intervene for the purpose of taking all such steps as may be appropriate for their protection in this proceeding.

WHEREFORE, the Commission respectfully prays for an order granting it leave to intervene in this proceeding for the purpose of moving this Court (a) to dismiss the Debtor's petition (129) herein, (b) to refuse confirmation of the Debtor's arrangement, and (c) to dismiss this proceeding, unless, within such time as may be fixed by this Court, the petition is amended to comply with the requirement of Chapter X for the filing of a Debtor's petition or creditors' petition under Chapter X is filed; and for such other and further relief as to this Court may seem just and proper in the premises.

Dated: New York, N. Y., December 1, 1954.

GEORGE ZOLOTAR,
Attorney for
Securities and Exchange Commission,
42 Broadway,
New York 4, N. Y.

(Verified by George Zolotar on December 1, 1954.)

Motion to Dismiss by Securities and Exchange Commission.

(131)

Upon the annexed affidavit of George Zolotar, its attorney, and all the proceedings had herein, the Securities and Exchange Commission moves to dismiss the Debtor's petition on the grounds that the petition was not properly filed under Section 322 because the provisions of Chapter XI of the Bankruptcy Act do not apply to a debtor corporation which has securities outstanding in the hands of the public.

Motion to Dismiss by Securities and Exchange Commission.

The Securities and Exchange Commission further moves that the Court dismiss this proceeding on the grounds that the proposed arrangement cannot properly be confirmed and the proceedings may therefore be dismissed because, for the reasons set forth in the preceding paragraph, in the annexed affidavit of George Zolotar, and in the accompanying Motion for Leave to Intervene, the proposed arrangement has not been made in good faith, as required by Section 366.

WHEREFORE, the Securities and Exchange Commission respectfully prays for an order (a) dismissing the Debtor's petition for relief under Chapter XI of the Bankruptcy Act, (132) as amended, and (b) dismissing this proceeding, unless the petition is amended to comply with the requirements of Chapter X for the filing of a debtor's petition, or a creditors' petition under Chapter X is filed, and for such other and further relief as to this Court may seem just and proper in the premises.

Dated: New York, N. Y., December 1, 1954.

GEORGE ZOLOTAR,
Attorney for
Securities and Exchange Commission,
42 Broadway,
New York 4, N. Y.

Affidavit of George Zolotar, in Support of Motion to Dismiss.

(133)

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss.:

GEORGE ZOLOTAR, being duly sworn, deposes and says:

I am Attorney for the Securities and Exchange Commission.

I make this affidavit on information and belief in support of motion of Securities and Exchange Commission to dismiss the Debtor's petition for an arrangement with creditors and to dismiss these proceedings. The sources of my information and the grounds for my belief are documents filed in this proceeding, records and documents filed with the Securities and Exchange Commission, and investigations made by members of the staff of the Securities and Exchange Commission.

I

On October 18, 1954 General Stores Corporation, the Debtor, filed a petition in this Court under Section 322 of the Bankruptcy Act proposing an arrangement under Chapter XI of the Act.

(134) By order to show cause, dated November 9, 1954, on the petition of Max Shlensky, a stockholder of the Debtor, verified October 28, 1954, the Debtor and the Commission were directed to show cause why an order should not be entered dismissing the proceedings under Chapter XI unless the petition be amended to comply with the requirements of Chapter X for the filing of a debtor's or creditors' petition under such chapter. Upon the hearing of the order to show cause on November 26, 1954, the matter was adjourned to December 2, 1954 with a direction to the Commission to be ready to proceed at that time. These papers have been prepared within the limited period thus allowed.

Affidavit of George Zolotar.

II

The Debtor, successor by change of name to D. A. Schulte, Inc., has outstanding 2,232,422 shares of its $1 par value common stock held in substantial part by upwards of 7,000 stockholders. The common stock is listed on the American Stock Exchange and is in part registered with the Securities and Exchange Commission pursuant to the Securities Act of 1933.

The Debtor's common stock was initially issued in connection with the promulgation of a plan of reorganization pursuant to Section 77B of the Bankruptcy Act, which plan was dated as of June 1, 1938 and consummated as of the close of business on October 31, 1940. At consummation there were authorized 2,250,000 shares of common stock, of which 667,807.01 shares were issuable under the plan, 1,458,886.25 shares were reserved for conversion of an issue of 58,355.45 shares of $25 preferred stock and 75,000 shares were reserved for issuance to officers and employees. (135) By October 31, 1951 all the preferred shares had been retired or converted and there were outstanding 1,457,843 shares of common stock. In July 1951 Frederick Lewisohn, on behalf of himself and eight associates, made an offer to the company to purchase from it for investment 400,000 shares of common stock at $1.50 per share. The offer was conditioned upon the granting of successive options; the first to purchase 196,079 shares at $1.60 per share within 18 months and the second, dependent upon exercise of the first, to purchase 196,078 shares at $1.70 per share within 36 months. Pursuant to action of the stockholders and the Board of Directors, the transaction was consummated on November 7, 1951 by the sale of 400,000 shares for $600,000 and the delivery of the options expiring respectively on May 7, 1953 and November 7, 1954. Thereafter, such shares and options were resold and reallocated to other persons for investment.

Affidavit of George Zolotar.

In November 1952 the Debtor registered with the Securities and Exchange Commission 741,657 shares of its common stock, representing 50,500 shares less than the aggregate of the shares sold and optioned in 1951. The registration was on behalf of the transferees of the shares and options and was designed to enable the transferees to sell their shares on the Exchange, a condition upon which the transferees insisted prior to exercising the option expiring May 7, 1953. The option was exercised and the registration statement, dated November 12, 1952, has been periodically revised, the last revision being dated July 21, 1954. At that date, it appeared that 404,769 shares had been sold pursuant to the registration statement.

(136) On May 19, 1954, when 2,053,922 shares were outstanding, the Debtor sold an additional 178,500 shares of its common stock to a group of 19 persons at the price of $1.375 per share to be held by them for investment. At that time the Debtor announced its intention to offer for sale not more than 121,500 additional shares of common stock to a group of about 10 persons, also to be held for investment. Thus, it appears that the Debtor had outstanding 2,232,422 shares of its $1 par common stock at July 21, 1954.

III

The Debtor was organized in 1915 and throughout most of its history operated a chain of stores for the sale of tobacco and accessory products as well as other sundry items. After the 77B reorganization proceeding and during the war years the Debtor enjoyed a profitable operation due principally to wartime scarcities. In the postwar period, however, the Debtor's volume began to fall. In addition, the Debtor's profit margin, already low with respect to most of its products, became narrower as prices declined and costs rose. Attempts at modernization of existing units failed materially to stem continuing losses.

Affidavit of George Zalotar.

The sale of the 400,000 shares of common stock in 1951 was accompanied by a change in the management of the enterprise. It was announced at that time that the $600,000 proceeds of the stock sale would be used to convert a number of the existing units to candy or food and drink operations in order to improve profit margins and thus reduce the company's losses. After consummation of the stock sale, however, further studies of the program were made and, upon discovery that costs of conversion would be too great, the program was abandoned and the proceeds of the (137) sale were used for general corporate purposes. During the four years and five months ended March 31, 1953 the Debtor sustained aggregate losses exceeding $2,700,000. With the continuance of losses in 1953 and 1954[1] the Debtor embarked upon a program of discontinuing the operation of its Schulte-type stores.[2]

In August 1953, the Debtor purchased all of the outstanding capital stock of Stineway Drug Company. Stineway operates a chain of 23 retail stores in the Chicago area engaged in selling drugs, cosmetics, tobacco products, drug sundries, candy and liquor; all but one of the stores also operate fountains and luncheonettes. In addition, Stineway operates a public cafeteria and sells merchandise to 12 independent stores in the Chicago area known as Stineway System Stores. The purchase price of this stock was $1,220,320.50, $800,000 of which was paid by the Debtor at the closing and the balance was to be paid on April 15, 1954. Of the $800,000 down payment, $365,000 was ultimately borrowed by the Debtor from Stineway; according to the company's latest prospectus, the Debtor borrowed an aggregate of $870,000 from Stineway to pay part of the purchase price.

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[1] For the five years and five months ended March 31, 1954 the Debtor sustained losses exceeding $4,200,000.

[2] At July 21, 1954, 146 such stores were in operation.

IV

Early in 1954 the Debtor contracted to purchase all the capital stock of Ford Hopkins Company. Ford Hopkins is engaged in the operation of a chain of 38 drug stores and three restaurants principally in Chicago (138) as well as elsewhere in Illinois and in Indiana, Iowa and Wisconsin. Ford Hopkins also owns all the stock of Sargent's Drug Store, the operator of five stores in the Chicago area, and supplies approximately 700 grocery chain stores with standard cosmetic items.

The purchase price of the Ford Hopkins stock was $2,800,000, payable $735,000 upon consummation and the balance over a period of years, at 4% interest. The down payment of $735,000 was derived from (1) the proceeds of the sale of 178,700 shares of common stock in May 1954: $245,438; (2) the proceeds of loans, including one from the Debtor's president: $55,000; and (3) the proceeds of a loan from Stineway: $440,000.*

To secure the balance of the purchase price, $2,065,000, the Debtor transferred the following collateral to a Trustee: (1) all of the capital stock of Ford Hopkins and Stineway; (2) dividends payable upon Ford Hopkins and Stineway stock; (3) life insurance policies aggregating $1,700,000 upon the life of the Trustee (one of the sellers); (4) the Debtor's rights to commissions payable to it by Ford Hopkins and Stineway under service contracts based generally upon 1% of the respective net sales of Ford Hopkins and Stineway.

After the consummation of the Ford Hopkins purchase, the indebtedness of the Debtor to Stineway was represented by two non-interest bearing notes, in the amount of

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* Stineway derived this cash from the sale of warehouse inventory to Ford Hopkins. Ford Hopkins in turn was required to borrow $400,000 from a bank in order to pay for the inventory.

$225,000 payable December 15, 1954 and in the amount of $1,085,000 payable June 1, 1964. It should be noted that (139) whereas in connection with the purchase of Stineway in August 1953, the net worth of Stineway was estimated at about $1,400,000, in connection with the purchase of Ford Hopkins the Stineway net worth, exclusive of the $1,085,000 note payable by the Debtor in 1964, was estimated at $500,000.

V

The plan of arrangement proposed by the Debtor provides for the payment of priority and administration creditors in accordance with such terms as may be arranged between the Debtor and such creditors. Unsecured creditors are to receive 100% of their respective claims payable 20% upon confirmation of the plan and 20% annually thereafter.

The summary of the assets and liabilities as taken from the Debtor's schedules is as follows:

ASSETS

Deposits of money in banks and elsewhere		$ 182,006.58*
Debts due on open accounts		41,324.74
Notes receivable		26,357.36
Stock in trade		400,000.00*
Furniture and Fixtures		125,000.00*
Investment in:		
Stineway Drug Company	$1,254,045.00	
Ford Hopkins Company	2,892,688.00	4,146,733.00
Leasehold		Undetermined
Total		$4,921,421.68

* Estimated Books and records Attorney's fees $15,000.00

Affidavit of George Zolotar.

Debts

Wages (priority)	$ 440.47
Taxes due United States, states and local authorities	Undetermined
Notes Payable:	
Secured	2,065,000.00
Unsecured	1,310,000.00
Other unsecured claims	524,970.09
Total	$3,900,410.56

VI.

(140) In view of the Debtor's financial history and condition, the interests of the Debtor's large class of public stockholders require an intensive and disinterested investigation such as is available under Chapter X into the acts and conduct of the Debtor and its officers, its financial condition, the operation of the business and the desirability of its continuance.

After incurring substantial losses over a period of years, the Debtor's management determined to liquidate and discontinue operation of the Schulte-type stores at an estimated loss of $655,000. Largely with borrowed monies, the proceeds of sale of additional stock to persons close to management, and the syphoning off of cash from purchased companies, it has acquired ownership of two drug chains operating in the Chicago area. Thus, within a brief space of time, a complete changeover of the Debtor's business has taken place; from the direct operations of a chain of stores located principally in the eastern portion of the United States, the Debtor has become a holding company of two drug chains operating in the midwestern portion of the United States.

Unlike Chapter XI, Chapter X provides adequate means for a disinterested analysis of the Debtor's financial condition, the desirability of the continuance of the enterprise as presently constituted or on any other basis, in order to provide the Court, the parties and the creditors and stockholders with a basis for the (141) exercise of an informed judgment as to the fairness and feasibility of reorganization proposals.

(Sworn to by George Zolotar on December 1, 1954.)

Affidavit of Leon Singer, in Opposition to Motion to Dismiss.

(142)

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.:

LEON SINGER, being duly sworn, deposes and says that he is an attorney at law and a member of the firm of Blumberg, Singer, Heppen & Blumenthal with offices at 350 Fifth Avenue, New York, N. Y.

Deponent's firm represents a large and substantial number of the unsecured creditors in this matter, approximating $150,000, and in behalf of which creditors they nominated a creditors' committee who were at the first meeting of creditors of the debtor on November 23, 1954, duly elected as such.

A meeting of such Committee will shortly be held at the office of your deponent's firm for the purpose of designating counsel, checking into the affairs of the debtor, examining the proposed plan for arrangement of the debtor, and making of such recommendations as they conclude.

Affidavit of Leon Singer.

On behalf of the creditors and the creditors' committee we appear in opposition to the motion to dismiss the proceedings under Chapter XI and for an amendment of the petition so as to comply with the requirements of Chapter X.

(143) The debtor company has for many years conducted a chain of retail units principally selling tobacco products, and more recently has acquired the entire capital stock of two chains in the Middle West known as the Steinway Drug Company, consisting principally of drug stores and cafeterias and the Ford Hopkins Company, consisting principally of drug stores. At the date of the filing of the Chapter XI proceedings, the aggregate assets of the Debtor as far as your deponent has been able to ascertain are approximately $3,500,000 and the liabilities approximately $1,700,000. The principal asset of the Debtor consists of its equity in the capital stock of the said Steinway Drug Company and Ford Hopkins Company of approximately $2,000,000, being that portion of the purchase price paid on account of the total purchase price paid for said stock of $4,000,000. Accordingly, at the date of the filing of petition in this proceeding there was a balance due and owing of approximately $2,000,000 on the purchase price, which sum is due to be paid in various installments under purchase agreement and trust indenture pursuant to which the entire capital stock of both said companies was deposited as security for the payment of said unmatured balance of purchase price. Deponent is informed that under said purchase agreement and trust indenture the filing of a petition in bankruptcy, or for an arrangement under Chapter X, or a petition for reorganization under Chapter XI, is an event of default and that the debtor has obtained from the Trustee and the Seller, before the filing of the within petition, a waiver as to a default by the filing of within petition for an arrangement but limited to a period not to exceed six months.

This is stated at the outset to point out to this court that if there is to be a reorganization and these (144) proceedings amended to a Chapter X proceeding, that will constitute an event of a default under said purchase agreement and trust indenture, unless the Seller and the Trustee therein waive such default, as to which there is no assurance, thereby causing the loss of the most valuable asset of the Debtor, without which the Debtor company would be hopelessly insolvent.

The vast majority of the unsecured creditors of the Debtor are trades people, most of whom have been selling tobacco products to the Debtor company for many years. They have been asked to and in many instances have agreed to continue to sell to the Debtor during the pendency of these proceedings, in the expectation that the Debtor will be able promptly to make a satisfactory arrangement with its creditors. Under the plan for arrangement herein the Debtor indicated its desire to pay creditors in full over a period of years and accordingly seeks the consent to the extension of the time for payment by said creditors. If such consent were to be procured, nothing is contemplated by this proceeding which would change the stockholders' relative rights or subordinate their interest in any way different from what which now exists.

In your deponent's opinion the purpose and intent of Chapter XI was to make adequate provision for just the type of arrangement as is here contemplated by the Debtor, for under the proceedings sanctioned by this section the difficulties of this Debtor company could be expeditiously disposed of without undue complication, delay or expenditure. Moreover, it would appear to deponent, because of the simplicity of the stock set-up of the Debtor and the non-complexity of its debt structure, entire and adequate (145) relief is obtainable by the Debtor under a Chapter XI proceeding.

On the other hand, were this proceeding to find its way into Chapter X, with the attendant delay and complications, there is every reason to believe that the support of the creditors which is so necessary for the continued operations of the Debtor would be lost. There does not appear to be any cogent reason in the moving papers offered as a reason for this transfer. To say that because the Debtor company is listed on a public Stock Exchange makes this a case for Chapter X is, of course, without any foundation and fact. It is respectfully submitted that the recent "Transvision" case decided by the Court of Appeals of this Circuit (to which reference will be made in an oral argument) is a complete answer, particularly in view of the consent of the Debtor to permit the intervention of the Securities and Exchange Commission in this proceeding, in which your deponent on behalf of his creditors is prepared to join.

Because of all of the foregoing, deponent respectfully prays for the denial of this motion.

(Sworn to by Leon Singer on November 30, 1954.)

Affidavit of N. Clarkson Earl, Jr., for Denial of Motion to Dismiss.

(146)

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss.:

N. CLARKSON EARL, JR., being duly sworn, deposes and says:

1. I am President, Director and Stockholder of General Stores Corp., the above named debtor, and submit this affidavit in opposition to the motion made by Max Schlensky

to dismiss the Chapter XI proceedings initiated by the debtor.

2. The Chapter XI proceedings were initiated by the debtor pursuant to Section 322 of the Bankruptcy Act by the filing of a petition on October 18, 1954. With its petition, the debtor proposed the following plan of arrangement with its general unsecured creditors:

A. Priority Creditors.

All creditors entitled to priority shall be paid in full in accordance with terms that may be arranged between the Debtor and the said priority creditors.

B. Other Unsecured Creditors.

The Debtor proposes that the rights of the other unsecured creditors be modified so as to provide for the payment to that class of creditors of a sum equal to 100% of their respective claims payable 20% upon confirmation of the plan and 20% annually thereafter.

C. Administration Expenses.

All administration expenses and allowances shall be paid in cash by Debtor upon confirmation of the plan or in accordance with terms that may be arranged between the Debtor and the persons to whom said expenses shall be payable.

(147) 3. At the time of the filing of the petition, an order was granted by Judge John W. Clancy extending for ten days the time for the filing of schedules, statement of affairs and executory contracts pursuant to Section 324 of the Act. On October 28, 1954, pursuant to said order, the debtor filed in these proceedings its schedules and state-

ment of affairs. The following is a summary of the assets and liabilities of the debtor as furnished to creditors with the referee's notice calling the first meeting of creditors:

Debts		
Wages (priority)		$ 440.47
Taxes due United States, states and local authorities		Undetermined
Notes Payable:		
Secured		2,065,000.00
Unsecured		1,310,000.00
Other unsecured claims		524,970.09
Total		$3,900,410.56
Assets		
Deposits of money in banks and elsewhere		$ 182,006.58
Debts due on open accounts		41,324.74
Notes receivable		26,357.36
Stock in trade		400,000.00
Furniture and Fixtures		125,000.00
Investment in:		
Stineway Drug Company	$1,254,045.00	
Ford-Hopkins Company	2,892,688.00	4,146,733.00
Leaseholds		Undetermined
		$4,921,421.68

(148) 4. On October 19, 1954, Hon. John E. Joyce, the referee in bankruptcy to whom the proceedings were referred, granted an order continuing the debtor in possession of its property and authorizing it to continue the operations of its business. The debtor has, as a debtor in possession, continued those operations. No indemnity has been required of the debtor as a condition to its authority to continue such operations.

5. The debtor is a New York corporation and prior to February 15, 1954 was known as D. A. Schulte, Inc. For many years prior to the filing of the petition, the debtor operated a chain of retail stores in the City of New York and in many other cities in the United States in which stores the debtor sold at retail, tobacco, tobacco products, smokers' supplies and accessories and sundry articles of wearing apparel, accessories, candy and confectionery items. At the time of the filing of the petition, the debtor was operating 76 stores.

6. The creditors affected by the debtor's plan of arrangement are solely its general unsecured creditors and the plan proposes an extension of time to pay these creditors. The debtor's general unsecured obligations may generally be divided into two categories: (a) Those owing for merchandise, services, supplies, rents and salaries shown in the summary to aggregate $524,970.09; and (b) those owing on notes payable to Stineway Drug Company, the debtor's wholly owned subsidiary, aggregating $1,310,000.00.

7. The debtor has no funded debts by way of debentures, certificates of indebtedness of any kind, bonds, mortgages, notes or obligations of like character sold, distributed or in the hands of the general public.

(149) 8. No secured obligation and no securities of any kind are affected by or intended to be modified in any manner or form by the proposed plan. The secured notes of $2,065,000.00 referred to in the above summary, consist of two notes of the debtor, one in the principal sum of $1,605,913.87 payable to the order of Lewis J. Ruskin, and the other in the principal sum of $459,086.13 payable to the order of Rexall Drug Company. These two notes represent the unpaid balance of the purchase price for the capital stock of Ford-Hopkins Company (which by said purchase became a wholly owned subsidiary). These two notes are secured by the deposit of the capital stock of the debtor's two wholly owned subsidiaries above mentioned.

9. The proposed plan does not affect nor seek to modify in any manner or form the capital stock of the debtor. Contrary to the allegations of the petitioner on this motion, the debtor's capital structure is not a complicated one. In fact, it is the simplest one possible. It consists of an authorized capital stock of 3,000,000 shares of common stock of the par value of $1.00 each, and there is issued and outstanding at this time 2,053,922 shares. There is no preferred stock issued or authorized nor is there more than one class of stock.

10. The debtor has been advised by its counsel that it can obtain full and adequate relief under Chapter XI of the Act, since it desires merely to obtain an adjustment of its obligations to its general unsecured creditors. It has been further advised by its counsel that in view of the fact that full and adequate relief can be obtained under Chapter XI, a petition, if originally filed under Chapter X, would have been dismissed by the court as not being filed in good faith pursuant to the provisions of Sections 130 and 146 (2) of the Act.

(150) 11. The plan proposed by the debtor in the Chapter XI proceedings will benefit the interests of stockholders since it is designed to adjust the obligations owing to general unsecured creditors. Since it is not proposed to change, modify, or affect in any manner the rights, powers and privileges of the stockholders or to amend or modify in any respect any of its secured obligations (which consist only in the two secured notes above mentioned), proceedings under Chapter X would have no purpose and no objective whatsoever except to impose upon the estate unnecessary costs, expenses, and harmful delays.

12. Reference has been made to the purchase by the debtor of the stock of Stineway Drug Company and of Ford Hopkins Company, and the Movant, by innuendo, has suggested possible irregularities therein. The purchase of the stock of these valuable drug-store chains in the Middle West was made by the debtor on notice to, and with full approval of its stockholders. Attached hereto, marked Exhibit A and made part hereof, is a copy of a letter dated January 18, 1954, written by deponent to the debtor's stockholders, accompanying the notice of the annual meeting of stockholders called for February 10, 1954. The Court will observe that in that letter I refer to the acquisition of Stineway Drug Company and state that that purchase was part of a comprehensive plan to acquire other merchandizing establishments. I further informed the stockholders that the debtor was presented with an opportunity to acquire the Ford Hopkins Company and pointed out that the combined volume of sales of both Ford Hopkins Company and Stineway Drug Company during the fiscal year just passed totalled approximately $24,652,000.00. At the meeting of stockholders held on February 10, 1954, they approved by the requisite vote all the steps taken and to be taken specified in the notice of meeting.

(154) 13. Whatever actions the debtor has taken during the current year with respect to its operations have not only been with the full knowledge and approval of its stockholders but were performed for the best interests of stockholders. If the moving petitioner genuinely believes that management has been guilty of any alleged wrongs, he should seek redress in an appropriate stockholder's derivative action rather than jeopardize the interests of creditors and other stockholders by interfering with the orderly procedure accorded the debtor by Chapter XI to compose its general unsecured debts.

14. Long prior to the institution of the Chapter XI proceedings the debtor had begun to close a large number of its Schulte-type cigar stores because they were operating at a loss at the store level. The principal contributing causes for such losses were the high rents under burdensome leases. In the pending Chapter XI proceeding the referee has already granted the debtor's application to reject a number of these leases as burdensome and applications for like relief are pending with respect to others. Such proceedings will reduce, if not completely eliminate, the losses heretofore sustained in the operations of these stores. A dismissal of the Chapter XI proceedings or a transfer thereof to Chapter X would not only inevitably delay the rejection of these burdensome leases but would, as a result, create claims of considerable magnitude by landlords for use and occupation of the premises which would be accruing daily during the pendency of the proceedings. In the pending Chapter XI proceedings this preferred liability is being expeditiously curtailed and will shortly be entirely eliminated.

15. In addition to the foregoing, proceedings under Chapter X would endanger the debtor's interest in the

aforementioned two wholly-owned subsidiaries. The debtor values that interest at more than $2,800,000.00. All of the capital stock in (152) these two subsidiaries has been pledged to secure the payment of the two notes aggregating $2,065,000.00. Under the collateral agreement governing the pledge these notes immediately become due and payable with the consequent right of foreclosure to the holders in the event that a trustee is appointed for the debtor or the debtor files a petition for relief under any chapter of the Bankruptcy Act. The debtor has secured from the holders of the notes a commitment in effect waiving the default caused by the filing of a petition under Chapter XI. However, this commitment specifically reserves to the holders of the notes the default occurring in the event that the proceedings are changed to Chapter X and/or a trustee is appointed. Thus the valuable interest of the debtor in these two wholly-owned subsidiaries with which the future success of the debtor is inextricably connected would be placed in jeopardy with possible loss to creditors and stockholders, by resort to the wholly unnecessary proceeding under Chapter X.

16. Based upon the facts presented and the applicable law, and mindful of the equities which weigh heavily in favor of continued proceedings under Chapter XI, deponent respectfully prays that the application be denied.

(Sworn to by N. Clarkson Earl, Jr., on November 26, 1954.)

"Exhibit A", Annexed to Foregoing Affidavit.

(153)

D. A. Schulte, Inc.
380 Broadway
New York 13, N. Y.

To the Stockholders of

D. A. Schulte, Inc.

There is enclosed herewith a notice of Annual Meeting of Stockholders, Proxy and Proxy Statement, for the purpose of electing a Board of eleven Directors, amending the Certificate of Incorporation to increase the authorized capital stock of the Company from 2,315,000 shares of common stock to 3,000,000 shares, approving the sale of 300,000 shares to A. C. Allyn and Company, Incorporated, of Chicago, at $1.37½ per share of a total of $412,500, changing the name of the Company from D. A. Schulte, Inc. to General Stores Corporation and selecting certified public accountants.

On September 30, 1953, I wrote to the stockholders about our acquisition of the Stineway Drug Company in Chicago. I stated that the purchase was part of a comprehensive plan to acquire other merchandising establishments.

I also stated that the Schulte Company was continuing to effect economies of operation, but I called attention to the fact that the gross profit margin on our staple items had decreased substantially in the past few years. I also pointed out that our costs have substantially advanced during this period. It is clearly apparent, therefore, that it would be in the best interest of our Company to move decisively into profitable fields such as chain drug and variety stores rather than confine ourselves to the small tobacco type store with which we have been traditionally associated and in respect of which the prospect of profit grows ever dimmer.

"Exhibit A" Annexed to Foregoing Affidavit.

Your management was delighted, therefore, when following the acquisition of the Stineway Drug Stores, we were presented with an opportunity to acquire the Ford Hopkins Company, which operates a chain of approximately fifty-five drug stores, principally in Chicago, as well as in the States of Illinois, Indiana, Iowa and Wisconsin. The financial statements of Ford Hopkins, certified by Altschuler, Melvoin and Glasser, independent public auditors, are contained in the accompanying Proxy Statement. According to these figures, Ford Hopkins has a net worth of approximately $2,616,000, had a volume of sales during the past fiscal year of approximately $16,492,000, and its average annual net income before taxes for the past three years has been approximately $170,000 and before depreciation $414,000. Stineway, during the past fiscal year had a volume of sales of approximately $8,160,000 and its net income before taxes has averaged approximately $170,000 during the past three years, and before depreciation $265,000. The combined volume of sales of both Ford Hopkins and Stineway during the past fiscal year totalled approximately $24,652,000. Moreover, because many of the Ford Hopkins stores are located in Chicago, the operation of Ford Hopkins and Stineway under a single management will bring about economies of operation as a result of which the total earnings of the two companies should be well in excess of what they have previously been when conducted as separate enterprises.

The pending proposal for the acquisition of substantially all of the stock of Ford Hopkins calls for a total purchase price of $2,800,000, payable $735,000 upon the signing of a contract and the balance of $2,065,000 over a period of years according to a formula under which there would be paid a minimum of $200,000 a year, plus one-half of the combined net earnings of Ford Hopkins and Stineway in excess of $200,000, before provision for Federal income

Exhibit A" Annexed to Foregoing Affidavit.

taxes or depreciation but after certain deductions including any Federal income taxes actually paid during the year. The precise terms and conditions of the purchase have, of course, yet to be worked out but the foregoing represents a broad outline of the proposed transaction.

The cash resources of the Schulte Company, Stineway and Ford Hopkins, and the future earnings of the latter two companies, will be sufficient to finance the purchase (as well as to pay the balance of $420,000 due on April 15, 1954 for purchase of the Stineway stock), except for approximately $350,000, which must be raised in the form of equity capital.

In attempting to accomplish the acquisition of Ford Hopkins, which your management believes would so dramatically advance the interests of your Company, we have sought to find such equity capital. We have succeeded in working out an arrangement with A. C. Allyn and Company, Incorporated, of Chicago, Illinois under which the Allyn Company will purchase 300,000 shares of Schulte common stock at $1.37½ per share or a total of $412,500. The Allyn Company will, in turn, grant participations to a limited number of individuals, all of which is more fully set out in the enclosed Proxy Statement. The stock purchase by the Allyn Company is conditioned upon the successful conclusion of negotiations for the purchase of the Ford Hopkins stock.

For the foregoing reasons, the management believes the increase in the authorized capital stock of the Company and the approval of the proposed stock sale to the Allyn Company is highly desirable. It considers the Company fortunate in being able to attract equity capital to carry out its plan for developing the business of the Company along profitable lines.

The proposed change of name of the Company to General Stores Corporation is designated to reflect the growth of

the Company beyond the tobacco shop, which the former name symbolized, and the launching of a vigorous new enterprise in the chain drug field.

Inasmuch as the votes of two-thirds of the stockholders are required for the approval of the proposal, may we urge you to return the enclosed Proxy to us at your earliest convenience.

Sincerely yours,

N. Clarkson Earl, Jr.,
President.

January 18, 1954.

Notice of Motion for Reargument.

(163)

Sirs:

Please take notice that the undersigned will move at a term for motions of the United States District Court for the Southern District of New York to be held at Room 506 in the United States Courthouse, Foley Square, Borough of Manhattan, City of New York, on the 15th day of February, 1955, at 10:30 o'clock in the forenoon of that day or as soon thereafter as counsel can be heard for the following relief:

For reargument of the motion heard, and on January 24, 1955, decided with written opinion by Judge Edward J. Dimock dismissing these proceedings unless the petition be amended so as to comply with Chapter X; and

Upon such reargument for an order denying the motion to dismiss the above entitled (164) proceedings; and

Notice of Motion for Reargument.

For such other and further relief as may be proper in the premises.

Dated: New York, New York, February 7th, 1955.

Yours, etc.,

OTTERBOURG, STEINDLER, HOUSTON & ROSEN,
Attorneys for Debtor,
Office & Post Office Address,
200 Fifth Avenue,
New York 10, New York.

To:

REICH, PELLER, GUADAGNO & CAINE, Esqs.,
Attorneys for stockholder Max Shlensky,
221 West 57th Street,
New York 19, New York.

SECURITIES AND EXCHANGE COMMISSION,
42 Broadway,
New York 4, New York.

BLUMBERG SINGER, HEPPEN & BLUMENTHAL, Esqs.,
Attorneys for Creditors' Committee,
350 Fifth Avenue,
New York, New York.

Memorandum in Support of Motion for Reargument.

(165)

STATEMENT

On October 18, 1954, General Stores Corporation filed its petition under Chapter XI and, on December 2, 1954, the motion to compel transfer of these proceedings to one under Chapter X was argued and, on January 24, 1955, decision was rendered.

It is apparent from the decision that the Court has overlooked the fact that during the interval much has transpired in the proceedings to the point where it is now clear that as a practical matter supervision is no longer necessary. More important is the fact which also appears to have been overlooked, namely that transfer of these proceedings to Chapter X would reduce the fund available to pay unsecured creditors and would probably be (166) disastrous to the interest of stockholders (Point II, page 10 herein).

Neither the statute nor the precedent relied upon by the Court constitutes any authority for the dismissal of these proceedings at this time unless the movants (the Securities and Exchange Commission and one stockholder) demonstrate affirmatively that adequate relief for the debtor in the best interests of creditors is not feasible and can not be obtained in this Chapter XI proceeding.

We feel that in following the learned dissertation by the Securities and Exchange Commission on the origin of section 77B and practice in Reorganization, this Court has overlooked the independent origin of Chapter XI for an Arrangement[1] and the extremely important amendments of 1952[2] which have advanced the law well beyond the

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[1] Section 12 of the Bankruptcy Act of 1898.

[2] Amending Sections 328 and 306(2) of the present Bankruptcy Act.

*U. S. Realty** and *Mecca Temple*** cases. The new law must affect the determination of the Court sitting now as distinguished from those Courts which sat before the Congressional amendment.

(167) Under the present law of Arrangement, stockholders are asked neither to consent to nor to forego or contribute anything. They gain by the scaling down or extension of the claims of unsecured creditors which permits the stockholders' company to reap the advantages of continuing. The business judgment of whether to continue must rest in management. This Court may not substitute its discretion for the judgment of management nor decree a transfer of this matter to Chapter X while management shows that such a transfer may well make impossible a continuance of the business. The Court has no affirmative finding to the contrary or one to the effect that a transfer to Chapter X would be in the *better* interests of stockholders since it can not be.

It now appears that the fund resulting from the liquidation of the Schulte store operation, as above referred to, being the only fund presently available for the payment of the claims of unsecured creditors, can not be dissipated by the expenses necessarily resulting from a transfer of these proceedings into Chapter X and still make a composition or Arrangement probable. There is also the very real threat that a Chapter X proceeding will result in loss of the Company's equity in the Stineway and Ford Hopkins stock.

(168) The conclusion is clear that in the best interest of stockholders as well as creditors a Chapter X proceeding is the *last thing* that should be entertained.

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* Securities and Exchange Commission v. United States Realty & Improvement Co., 310 U. S. 434, 60 S. Ct. 1044 (1940).

** Mecca Temple, etc. v. Darrock, 142 Fed. 2nd 869 (1944).

Memorandum in Support of Motion for Reargument.

DEVELOPMENTS SINCE THE ORIGINAL ARGUMENT OF THIS MOTION.

(1)

Since the initial argument last December, General Stores Corporation has now discontinued and removed from all its Schulte type stores, and liquidated its inventory and substantially all of its fixtures and no longer employs any of its operating personnel. Management consists of the Chairman of the Board, Mr. Waddill Catchings, its President, Mr. N. Clarkson Earl, Jr. (both serving without compensation), its Vice-President, Mr. Robert E. Woods, and its Secretary and Treasurer, Mr. C. Edward Brown.

In short, the General Stores Corporation presently holds two assets, namely, cash resulting from the said liquidation of the Schulte type stores and its equity as stockholder of all of the outstanding capital stock of Stineway Drug Company and Ford Hopkins Company. In addition, and applicable only for continued operations, (469) General Stores has a valuable Tax loss carry forward, meaning a very substantial tax saving on its future operations for a period of five years.

The equity in its stockholdings is subject to the trust agreement by which the stock is pledged to secure the purchase price of the stock in the Ford Hopkins Company. Management has obtained a waiver of the default provisions of the trust agreement for a period of time while these Arrangement proceedings are pending but the other provisions of the agreement remain in effect so that transfer to a proceeding under Chapter X would constitute an automatic default and give the pledgee a right to foreclose on the collateral.

(2)

Since the original argument of this motion the Securities and Exchange Commission has been denied an application for a rehearing in *Matter of Transvision, Inc.** and has petitioned the Supreme Court for a writ of certiorari to (170) review the question of whether a corporation having a considerable number of public investors may choose between the Corporate Reorganization procedure of Chapter X and the Arrangement procedure of Chapter XI, depending upon the type of plan it proposes, or whether it is restricted to the use of Chapter X.

The petition of the Securities and Exchange Commission, filed with the Supreme Court, which refers to our pending motion, in re *General Stores Corporation*, concedes that except for the *Mecca Temple* case, the opinion of the District Court in the *Transvision* case is the first reported decision since the *U. S. Realty* case on the question of the choice between Chapter X or Chapter XI.

General Stores Corporation in trying to effect an Arrangement with its creditors so that it may concentrate upon the Stineway and Ford Hopkins operations has no desire whatsoever to be treated as a *cause celebre* but would rather have its matter disposed of in the most practical fashion.

(171) POINT I.

ONLY THE CONSENT OF CREDITORS AS PROPERLY REQUIRED IN A CHAPTER XI PROCEEDING AS IT WAS UNDER THE COMPOSITION SECTION OF THE FORMER BANKRUPTCY ACT.

(1)

The Court in its original decision on this motion, when it speaks of the "reorganization" of General Stores Cor-

**Matter of Transvision, Inc.*, Fed. 2d , decided November 9, 1954.

poration, appears to have overlooked the important distinction that no reorganization of General Stores is here being sought. General Stores proposes a composition or Arrangement with its general unsecured creditors which is relief peculiar to and adequately obtainable in the Chapter XI proceeding.

This was probably not so during that period when the so-called rule of *Northern Pacific Ry Co.* v. *Boyd*,* was being applied to the requirement in a Chapter XI proceeding that the arrangement be "fair and equitable". As the Court in the *U. S. Realty* case said:

> "The hope of securing an arrangement which is fair and equitable and in the best interests of unsecured creditors, without some readjustment of the rights of stockholders such as may be had under Chapter X, but is precluded by Chapter XI, is at best but negligible * * *". (310 U. S. at 453).

It was with the foregoing decision expressly in mind that the Congress on July 7, 1952, deleted the trouble-making language and returned (172) to the original form of the composition section of the Bankruptcy Act of 1898 providing that the Court shall confirm an Arrangement (composition) when it is satisfied that the plan is for the best interests of the creditors and is feasible.

(2)

We believe the Court has overlooked the essential distinction in the interest represented by the Securities and Exchange Commission in the *U. S. Realty* and *Mecca Temple* cases and its interest in the *Transvision* and *General Stores* cases. In both of the older cases, the Court was hard put to find what was in the best interests of unse-

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* *Northern Pacific Ry. Co.* v. *Boyd*, 228 U. S. 482.

cured creditors because in both cases the holders of publicly distributed securities were being directly affected as general unsecured creditors in the plan of arrangement offered.

In the *U. S. Realty* case, general unsecured creditors were holders of mortgage certificates guaranteed by U. S. Realty, and in the *Mecca Temple* case they were holders of bonds constituting a debt of Mecca Temple. In both cases the question of what was in the best interests of such public creditors was something for which the Court was fully justified in seeking the aid of the Securities and Exchange Commission.

(173) In the *Transvision* and *General Stores* cases, however, the unsecured creditors do not include any members of the public holding securities of the debtor and the Securities and Exchange Commission has no claim to represent them. Since the Court by the 1952 amendment to Chapter XI is no longer concerned with the necessity for "reorganizing" the debtor (in the interests of creditors), the Securities and Exchange Commission has no compelling reason for being present in the interest of stockholders.

(3)

It seems to us that the Court has overlooked the discussion of the interrelation of the two Chapters X and XI of the Bankruptcy Act as referred to by the Court of Appeals in the *Transvision* case when it came to the conclusion that the statute "manifests a conscious purpose of Congress to encourage resort to Chapter XI whenever the remedy afforded thereby adequately protects the interests involved."

Since Congress in 1952 deleted the language "fair and equitable" which the Supreme Court said must necessarily involve publicly held corporations in a "reorganization"

whenever they sought an Arrangement or composition with their general unsecured creditors, it is not surprising (174) that the District Court and the Circuit Court in the *Transvision* case were unanimous in refusing to transfer the proceedings to Chapter X and to follow the decisions which preceded the legislative change*. We feel justified in moving for reargument since it is apparent that this important distinction, not referred to in this Court's opinion, has been overlooked.

(4)

We point out therefore that since the consent of creditors is the basic requirement of a proceeding in Chapter XI, and since the Securities and Exchange Commission has no interest on behalf of the creditors in this case, and no "reorganization" is required in this case, the Commission has no status whatsoever at this particular time to urge a dismissal merely because General Stores is publicly owned.

Congress, in amending the Bankruptcy Law in 1952 and particularly avoiding the necessity of "reorganizing" a corporation which merely seeks an Arrangement or composition with its creditors, thereby withdrew any mandate to the Securities and Exchange Commission to enter a proceeding solely because the debtor's stock was publicly held, if such a mandate had theretofore existed. The statute as amended places (175) *no* burden upon the corporate debtor to demonstrate that it ought *not* to be proceeding in Chapter X or that supervision by a Trustee was unnecessary.

On the contrary, since the corporation has proceeded for an Arrangement or composition with its unsecured creditors without the necessity of a reorganization or reshuffling of its capital structure, the burden must be upon the Se-

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* *U. S. Realty* and *Mecca Temple* cases, *supra*.

curities and Exchange Commission to demonstrate that supervision by a Trustee is necessary. In the present case no such demonstration has even been attempted.

POINT II.

A Chapter X Proceeding is Now Unnecessary and Would Probably be Disastrous.

(1)

The Court by permitting itself to be moved merely by a lack of demonstration that supervision was unnecessary has apparently overlooked the many points which affirmatively demonstrate in this case, and particularly at the present stage, not only that supervision is unnecessary but also that a transfer to Chapter X would seriously jeopardize the rights of all concerned whether they be creditors or stockholders.

(176) When Congress in 1952 manifested a more conscious purpose to encourage resort to Chapter XI in the interest of expedition, it was certainly aware of the expenses which are necessarily imposed and must be anticipated by a Chapter X proceeding. These include the compensation for services and the reimbursement of costs and expenses of the Trustee, the depositary, the reorganization manager, one or more committees of stockholders, one or more committees of creditors, and the attorneys or agents of each of them (Chapter X, Section 242).

Certainly such expenses would substantially deplete the cash fund of General Stores which is the only fund by which composition with its unsecured creditors may be effected. The only other asset is its equity in the collateral under the trust agreement.

As a practical matter also, the Court has apparently overlooked in this connection, that placing this Company

in the cumbersome Chapter X proceeding will constitute an automatic default in the trust agreement permitting the pledgee to realize upon the security. Any forced realization of the security is likely to leave little if anything to the stockholders of the Company.

(177) Since the liquidation of the Schulte type stores has been accomplished and the Company's equity in the Stineway and the Ford Hopkins chains is subject to the trust agreement, there is nothing left to be "supervised" in the present proceedings other than the ascertainment of claims and the securing of creditors consents to the composition.

The foregoing should constitute a complete demonstration that at least at this point in the proceeding, transfer of these proceedings to Chapter X and the consequent appointment of a Trustee and the intervention of a group of committees is not only unnecessary but very prejudicial to the interests of all concerned.

(2)

The Court has overlooked the fact that the debts owed to the unsecured creditors must be paid or scaled down, and to the extent that payment is extended or the debt scaled down, the interest of stockholders must necessarily be enhanced. In this case, therefore, the stockholders of General Stores are not asked to give up anything. There is no occasion here for any "blind" following by stockholders since they are not and will not in these proceedings be asked to give up or contribute anything.

(178) It seemed obvious at the initial hearing on this motion that all attorneys conceded that in an Arrangement proceeding the stockholders could not but be benefited since without the Arrangement the unsecured creditors had an absolute priority in the distribution of assets before stockholders.

It is in recognition of this reality and on no technical grounds that the consent of stockholders to the consummation of the Arrangement is not required and that the interest of the Securities and Exchange Commission in the Arrangement proceedings is only as a "stand-by" in the event reorganization or reshuffling of the capital structure may become necessary. At that time, and only at that time, might the Securities and Exchange Commission be justified in moving the case into Chapter X.

(3)

We do not argue with the Securities and Exchange Commission that they have a duty to perform in protecting the public stockholders of General Stores. In this connection, however, the Court has apparently overlooked the fact that the Securities and Exchange Commission has, (179) since November 1952, been fully informed of the operations of General Stores. The registration statement, dated November 12, 1952, has been periodically revised, the last revision being July 21, 1954. The Court is aware of the detail of balance sheets, history, operations and intentions, which are required by such registration statements.

Not only has the Securities and Exchange Commission kept itself informed by such registrations, but in addition, General Stores has kept its own stockholders informed with the important changes which have occurred in the acquisition of the Stineway and Ford Hopkins chains. On September 30, 1953, just after the Stineway chain had been acquired, Mr. N. Clarkson Earl, President of General Stores, wrote an informative letter to each of the stockholders telling them about the acquisition and why it was taking place. In accordance with Securities and Exchange Commission rules with regards to the solicitation of proxies, all of the pertinent material with regard to the acquisition of the Stineway chain and the proposed

acquisition of the Ford Hopkins chain, was mailed, with the notice of the annual meeting, to all stockholders. In soliciting (180) their proxy for the meeting of stockholders held on February 10, 1954, at which the necessary increase of the common stock of the Company and the sale of a portion of it was voted to assist in the financing of the Ford Hopkins acquisition, the Rules of the Securities and Exchange Commission required complete disclosure.

On June 30, 1954, Mr. Earl, as President, and Mr. Brown, as Secretary, sent letters to each of the stockholders reporting on the annual meeting and the actual acquisition of the Ford Hopkins chain.

One must conclude, therefore that at least since November, 1952, the stockholders of General Stores have had no reason to follow *blindly* the proposals of management in its efforts to bring a profitable operation out of the previous Schulte operation. There is no reason for the Securities and Exchange Commission to move for a transfer of these proceedings to a Chapter X proceeding on the excuse that the operations of the General Stores Corporation is one with which they are not fully familiar and for which they now somehow require the expensive aid of a trusteeship.

(184) (4)

The Securities and Exchange Commission by being permitted to intervene in these proceedings has obtained all of the practical benefits of status which it would have had under Chapter X, Section 208, and under Section 265. Having intervened there is nothing that prevents the Commission from making a report on the plan for Arrangement and composition as it would have been permitted to do under Chapter X, Section 172. That leaves only the provision of Chapter X, Section 175, requiring transmission of the Commission's report to all creditors and stock-

holders affected by the plan, which would have been done under Chapter X but for which no provision is made under Chapter XI.

Since the creditors are fully represented by an officially recognized creditors' committee in the present proceedings and by counsel, the circulation of a report by the Securities and Exchange Commission is not necessary for the benefit of creditors. Since there is contemplated no "reorganization" or "reshuffling" of the capital structure of the corporation which would affect stockholders (182) and since their consent to an arrangement or composition with general unsecured creditors is not required, a circularization of stockholders by the Securities and Exchange Commission in this proceeding would constitute unnecessary and unjustified expense.

The present situation can therefore be summarized as follows:

a. General unsecured creditors are fully represented by an official recognized creditors committee which has retained counsel and which opposes transfer of these proceedings into Chapter X as both unnecessary so far as their interest is concerned and highly prejudicial to any recovery that they may expect.

b. The Securities and Exchange Commission has been kept informed of all of the activities of this corporation since November 1953 through the filing of registration statements with the Commission from time to time. They are informed in great detail and particularly during all of the periods when the acquisition of the Stineway and Ford Hopkins chains was being considered and was actually achieved.

c. During the same period stockholders have been continuously informed through letters by the President

and Secretary and by the notice of meeting and solicitation of proxies material as approved by the Securities and Exchange Commission which has been sent to them. They have not followed management *blindly* in the various steps which have been taken to achieve a more profitable operation and the Schulte type stores.

(183) d. The Securities and Exchange Commission whose only legitimate interest in this proceeding would be on behalf of stockholders, has been permitted to intervene in this proceeding and will, of course, be given notice of all important steps taken in connection with it. That it may make an advisory report to the Court at any stage in this proceeding goes without saying. It is in a position at any time, to urge the dismissal of the present proceedings on specific facts relevant to this proceeding showing that in this proceeding an Arrangement cannot be achieved which is in the best interest of creditors and feasible.

e. So far as the orderly conduct of the proceeding is concerned, there is no necessity whatsoever for supervision since a liquidation has already occurred and all that remains is the ascertainment of claim and the accomplishment of the composition.

f. Chapter XI is adequate, therefore, and Chapter X would entail a very substantial additional expense which would seriously prejudice the rights of creditors. Creditors by their official committee have already objected to any transfer to Chapter X.

g. Finally, a transfer to Chapter X will be disastrous for stockholders for it means the automatic default under the trust agreement and the loss of the

company's equity in the stock of the Stineway and Ford Hopkins Chain. It means additional and substantial expense for trustees, committees and their respective counsel far in excess of the requirements of Chapter XI. Stockholders will be left with nothing.

(184) CONCLUSION

The problem is not a theoretical question of law but a practical application of the remedies of the Bankruptcy Act to be applied in this particular case. Of course, we deny that there is any statutory authority whatsoever for the argument of the Securities and Exchange Commission that Chapter XI is not available to a corporation whose stock is publicly held. That, however, is a matter being litigated in the Transvision case and presently before the Supreme Court of the United States.

The Court of Appeals has ruled that Chapter XI is available to a corporation with publicly held stock. We find no support in the statute for the dicta of the Court of Appeals in that case, repeating the dicta of much earlier cases, on the extent of the discretion in the District Court.

However, discretion can be applied in modification of statutory authority only upon demonstration of fact. It seems clear in the present case that the burden is upon the movants in these proceedings to demonstrate very clearly the extent to which a dismissal would be in the interests of creditors or (185) stockholders and to disprove what we have shown, namely, that a dismissal will be disastrous to both stockholders and creditors.

The liquidation of Schulte type stores has been accomplished and little is left to be done before an Arrangement or composition with the general unsecured creditors can be proposed in final form. It would seem clear that supervision of what remains to be done in these proceedings by a Trustee is totally unnecessary.

Affidavit of C. Edward Brown.

THE APPLICATION FOR REARGUMENT SHOULD BE GRANTED AND THE MOTION TO DISMISS DENIED.

Dated: New York, New York, February 7, 1955.

Respectfully submitted,

OTTERBOURG, STEINDLER, HOUSTON & ROSEN,
Attorneys for General Stores Corporation, Debtor.

Of Counsel:

AARON ROSEN,
FREDERIC P. HOUSTON,
MARKS F. PASKES.

Affidavit of C. Edward Brown, in Support of Motion for Reargument

(186)

STATE OF NEW YORK)
COUNTY OF NEW YORK)

C. EDWARD BROWN, being duly sworn, deposes and says:

1. I am the Secretary-Treasurer of General Stores Corporation and am thoroughly familiar with the pending proceedings under Chapter XI of the Bankruptcy Act.

2. Since October 18, 1954, when the petition under Chapter XI was filed, the Corporation as Debtor-in-Possession, has withdrawn from all of its Schulte type stores. It has liquidated all of its inventories and practically all its tangible assets. At the present time the only assets which it has consist of cash in bank, accounts and notes

receivable, and its equity in the capital stock of Stineway Drug Company and Ford Hopkins Company. As a going concern, General Stores Corporation also has a valuable asset of a substantial carry-forward operating loss for tax purposes.

3. In view of the fact that the Corporation has ceased being an operating company, it has substantially reduced its managing personnel. At the present time, management consists of X. Clarkson Earl, Jr., its President, serving without compensation, Waddiel Catchings, Chairman of the Board of Directors, also serving without compensation, Robert E. Woods, Vice-President, and deponent, Secretary-Treasurer.

(187) 4. The Corporation has heretofore kept its stockholders fully informed regarding the acquisition of the Stineway Drug Company and Ford Hopkins Company stock. Under date of September 30, 1953, a letter was sent to the stockholders of the Corporation by our President and I attach hereto as Exhibit "A" a copy of that letter. By that letter the President notified the stockholders that the Corporation has acquired the Stineway Drug Company, gave the purchase price for all of the capital stock, and indicated the net worth thereof.

5. In connection with the annual meeting of its stockholders held February 10, 1954, the Corporation, in accordance with the rules of the Securities & Exchange Commission, sent to its stockholders a notice of the meeting together with the proxy statement as required by those rules. A copy of the notice of that meeting and proxy statement is hereto attached, marked Exhibit "B" and made part hereof.

6. I respectfully call the attention of this Court to subdivision III on page 4 of the proxy statement wherein stockholders were informed that the company was then conducting negotiations for the purchase of substantially all of the outstanding stock of Ford Hopkins Company. In accordance with the rules of the Securities & Exchange Commission, copies of this notice, the proxy statement and reports which accompanied the same were filed with the Securities & Exchange Commission.

7. With the notice of the annual meeting and proxy statement (Exhibit "B" hereto attached), a letter dated January 18, 1954, was sent by the President of the Corporation to the stockholders and a copy of that letter is hereto attached marked Exhibit "C" and made part hereof. By that letter, the President referred to the prospective acquisition of the stock of the Ford Hopkins Company and explained the reason for that (188) purchase and the fact that the Corporation by virtue of the acquisition of both the Stineway Drug stores and the Ford Hopkins stores would be of great benefit to the future operations of the Company. That letter also explained the manner in which the Corporation would raise the necessary funds for the purpose of acquiring the Ford Hopkins stores.

8. At the meeting of stockholders held on February 10, 1954, the agreement between the Corporation and A. C. Allyn and Company, Inc. referred to in the notice of meeting and proxy statement which was the foundation for the acquisition of the Ford Hopkins Company was approved by the stockholders by requisite vote.

9. Under date of June 30, 1954, the President of the Corporation wrote to all of the stockholders advising them of the acquisition of the Ford Hopkins Company stock on

May 19, 1954. A copy of that letter of June 30, 1954, is hereto attached, marked Exhibit "D" and made part hereof.

10. It is therefore abundantly clear that all of the matters concerning which reference has been made by the moving stockholder and the Securities & Exchange Commission on their motion to dismiss these Chapter XI proceedings have, prior to the institution of these Chapter XI proceedings, been called to the attention of our stockholders and they fully approved all of the steps taken. Prior to the filing of the petition for arrangement, the Securities & Exchange Commission was likewise fully informed with respect to the activities of this Corporation.

11. What management is endeavoring to do in these Chapter XI proceedings must necessarily benefit these stockholders. Creditors of this Corporation have a prior right to its assets and to the extent that the claims of the creditors are scaled down or the payment thereof extended, the interest of stockholders must necessarily be served. There can be no (189) bona fide objection by stockholders to an extension and arrangement with creditors.

12. Negotiations are presently pending with the Creditors' Committee with reference to a proposed amended Plan of Arrangement. Under this Amended Plan of Arrangement, all of the general unsecured debts of the Corporation would be discharged by payment of a fraction thereof. It is indicated that this amended proposal may be accepted by the Committee and recommended to the creditor body. Under these circumstances, stockholders must necessarily benefit from the fact that the claims which have an interest in the assets of the Corporation ahead of stockholders are eliminated, and thus substantially improve stockholders' position. This will be accomplished

without asking stockholders to consent to or contribute anything. This is the clearest demonstration that adequate relief is being obtained in these Chapter XI proceedings.

13. It is also a convincing demonstration that the transfer of these proceedings to Chapter X would not only delay the prompt discharge of these debts but would make such an arrangement unlikely. Transfer to Chapter X will require the appointment of a Trustee, an attorney for the Trustee, one or more so-called stockholders protective committee, each with separate counsel, all eager to justify future applications for substantial fee allowances. What can be used now toward the discharge of creditor's claims will be dissipated by fees and disbursements allowed to all this wholly unnecessary personnel.

I respectfully request that the Debtor's application for reargument be granted, and upon such reargument, the motions to dismiss and to intervene be denied.

(Sworn to by C. Edward Brown, on February 18, 1955.)

Exhibit "A", Annexed to Foregoing Affidavit.

(190)

D. A. Schulte, Inc.
380 Broadway
New York 13, N. Y.

September 30, 1953

To the Stockholders of D. A. Schulte, Inc.:

You have probably read in your newspaper of the acquisition of the Stineway Drug Company by D. A. Schulte, Inc. Stineway, with its 22 drug stores and 14 franchised

Exhibit "A", Annexed to Foregoing Affidavit

Stineway System stores in metropolitan Chicago, did an annual drug, luncheonette, tobacco and liquor business in excess of eight million dollars during its last fiscal year. Stineway's earnings, after taxes, have averaged in excess of $100,000 during the past five years and its net worth is in excess of $1,400,000. The purchase price for all of the outstanding capital stock of Stineway was $1,220,320.50.

The purchase is part of an overall plan to acquire other independent non-competitive drug chains. Many industries in recent years have experienced considerable consolidation but in this field very few combinations have taken place.

Insofar as the operations of D. A. Schulte, Inc. are concerned, every effort is being made to increase sales volume to the point where profits will be realized. Although a loss will be shown for the current fiscal year, it is estimated that this loss will be lower than in previous years. Sales for the nine months ended July 31, 1953 were $12,376,265 as against sales of $13,456,666 for the same period in 1952. The estimated net loss, subject to year-end adjustments and audit, for such nine months period in 1953 is $253,310 as against $309,823 in 1952. During 1952 $50,016 of non-recurring income was realized from the sale of real estate.

We are continuing to effect economies of operation. As a result of the Steinway purchase, warehouse space has been obtained in Chicago and it is intended to utilize such space to service our Midwestern stores with a resultant decrease in overhead cost. It must be remembered that the gross profit margin on our staple items such as cigars, cigarettes, tobaccos and accessories which represent approximately 75% of the total sales has decreased from 25.59% in 1944 to 16.21% in 1953. Manufacturing costs have increased and thus the cost to us on all items is higher, but because of the highly competitive nature of our business we have been unable to sell merchandise at increases commensurate with the increase in our cost. Moreover, rents,

wages, maintenance costs, utilities and the like, have also considerably increased during this period.

Despite these great difficulties, however, your Management feels that definite progress is being made. Currently, a chain-wide contest is being held with prizes such as an automobile, a mink coat, a television set and many other awards, as a means of increasing store traffic and store volume. We are presenting a popular television program and are running substantial newspaper advertising.

If there is a Schulte or a Steinway store in your area please continue to patronize it and ask your friends to do the same. Your Directors and Management are exerting every effort to put D. A. Schulte, Inc. in the black and we trust the results will be evident in the not-too-distant future.

Cordially,

N. C. Earl, Jr.,
President.

Exhibit "B", Annexed to Foregoing Affidavit.

(191)

D. A. Schulte, Inc.

Notice of Annual Meeting of Stockholders

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* * * *

III. Amendment of Certificate of Incorporation to Increase the Authorized Common Stock of the Company from 2,315,000 Shares to 3,000,000 Shares.

The Company is presently authorized to issue 2,315,000 shares of common stock of the par value of $1 per share. On November 30, 1953 there were issued and outstanding

Exhibit "B" Annexed to Foregoing Affidavit.

2,053,922 shares. 196,078 shares are reserved for issuance pursuant to an option granted under a contract with Frederick Lewisohn which was approved at a Special Meeting of Stockholders held on October 5, 1951. 15,000 shares are reserved for issuance pursuant to an employee's restricted stock option, and 50,000 shares are reserved under the Certificate of Incorporation for issuance to officers and employees. At the present time all of the authorized 2,315,000 shares are thus either issued or reserved for issuance.

The management of the Company is presently conducting negotiations for the purchase of substantially all of the outstanding capital stock of Ford Hopkins Company, a Delaware corporation operating a chain of fifty-five drug stores in Illinois, Indiana, Iowa and Wisconsin. In order to enable the Company actually to enter into a purchase agreement, the Company needs additional cash in the form of equity capital. It proposes to sell 300,000 shares of common stock to A. C. Allyn and Company, Incorporated, all as more particularly herein set forth in item "IV" of this Proxy Statement. The Company has recently acquired all of the outstanding capital stock of Stineway Drug Company, which operates a chain of twenty-two retail drug stores, all of which are in and around Chicago, Illinois. The potential Ford Hopkins purchase and the changing business and financial conditions which characterize the present situation of the Company make it advisable that the Company have available sufficient common stock which may be used in the discretion of the Board of Directors to take advantage of this and other opportunities which may present themselves to purchase properties in the retail drug or related fields or to sell or to otherwise issue additional shares to obtain equity capital in order to take advantage of such opportunities. It is frequently neither possible nor practicable to call and hold special meetings of stockhold-

ers to provide an adequate number of authorized shares of common stock, and it is deemed in the best interests of the Company and its stockholders that an adequate amount of authorized shares be made available for such uses by the Board of Directors. The management intends to issue 300,000 shares of the newly authorized stock in connection with the transaction described in item "IV" of this Proxy Statement, if such transaction is approved by the stockholders. The Company has no present intention with respect to the future issuance of the additional 385,000 shares, or, if the transaction set forth in item "IV" of this Proxy Statement is not approved, with respect to the future issuance of the entire 685,000 shares, but the management deems it highly desirable that the Company have available this number of shares of authorized stock.

There are and will be no preemptive rights with respect to such additional 685,000 shares. If authorized, the additional shares may be issued by the Board of Directors from time to time for such consideration as they may determine without further approval of the stockholders. The issuance of additional shares of stock would, of course, affect the rights of existing stockholders to the extent that there would be outstanding a larger number of shares to participate in voting, dividends and distribution on liquidation. The Certificate of Incorporation of the Company provides that no increase shall be authorized in the common stock of the Company except upon the consent of the holders of two-thirds or more of the outstanding shares of common stock. The management recommends that the stockholders vote in favor of this proposal.

* * * *

As set forth above the management of the Company has been negotiating with Lewis J. Ruskin of Chicago, Illinois for the acquisition of substantially all of the outstanding capital stock of Ford Hopkins Company. An outline of the

Exhibit "B", Annexed to Foregoing Affidavit.

contemplated transaction is set forth in the letter to stockholders accompanying this Proxy Statement. None of the management of the Schulte Company has any interest in the Ford Hopkins Company and Mr. Ruskin has no interest in the Schulte Company. No agreement for the purchase and sale of the stock of the Ford Hopkins Company has as yet been entered into.

The management of your Company has been permitted to examine all of the appropriate financial statements of Ford Hopkins Company. Certain of the financial statements are annexed to this Proxy Statement.

It is expected that if the stockholders approve the issuance of the 300,000 shares of stock which are the subject of this proposal, agreement will be reached with Mr. Ruskin and the transaction of acquisition of the stock of the Ford Hopkins Company consummated as expeditiously as practicable. The management recommends approval of this proposal of sale to A. C. Allyn and Company, Incorporated. No stockholder approval is sought of the transaction of acquisition of substantially all of the outstanding shares of Ford Hopkins Company since the management is advised by counsel that none is required.

Exhibit "C", Annexed to Foregoing Affidavit.

(192)

D. A. Schulte, Inc.
380 Broadway
New York 13, N. Y.

To the Stockholders of

D. A. Schulte, Inc.

There is enclosed herewith a notice of Annual Meeting of Stockholders, Proxy and Proxy Statement, for the purpose of electing a Board of eleven Directors, amending the Certificate of Incorporation to increase the authorized capital stock of the Company from 2,315,000 shares of common stock to 3,000,000 shares, approving the sale of 300,000 shares to A. C. Allyn and Company, Incorporated, of Chicago, at $1.37½ per share or a total of $412,500, changing the name of the Company from D. A. Schulte, Inc. to General Stores Corporation and selecting certified public accountants.

On September 30, 1953, I wrote to the stockholders about our acquisition of the Stineway Drug Company in Chicago. I stated that the purchase was part of a comprehensive plan to acquire other merchandising establishments.

I also stated that the Schulte Company was continuing to effect economies of operation, but I called attention to the fact that the gross profit margin on our staple items had decreased substantially in the past few years. I also pointed out that our costs have substantially advanced during this period. It is clearly apparent, therefore, that it would be in the best interest of our Company to move decisively into profitable fields such as chain drug and variety stores rather than confine ourselves to the small tobacco type store with which we have been traditionally associated and in respect of which the prospect of profit grows ever dimmer.

Exhibit "C" Annexed to Foregoing Affidavit.

Your management was delighted, therefore, when following the acquisition of the Stineway Drug Stores, we were presented with an opportunity to acquire the Ford Hopkins Company, which operates a chain of approximately fifty-five drug stores, principally in Chicago, as well as in the States of Illinois, Indiana, Iowa and Wisconsin. The financial statements of Ford Hopkins, certified by Altschuler, Melvoin and Glasser, independent public auditors, are contained in the accompanying Proxy Statement. According to these figures, Ford Hopkins has a net worth of approximately $2,616,000, had a volume of sales during the past fiscal year of approximately $16,492,000, and its average annual net income before taxes for the past three years has been approximately $179,000 and before depreciation, $414,000. Stineway, during the past fiscal year had a volume of sales of approximately $8,160,000 and its net income before taxes has averaged approximately $170,000 during the past three years, and before depreciation $265,000. The combined volume of sales of both Ford Hopkins and Stineway during the past fiscal year totalled approximately $24,652,000. Moreover, because many of the Ford Hopkins stores are located in Chicago, the operation of Ford Hopkins and Stineway under a single management will bring about economies of operation as a result of which the total earnings of the two companies should be well in excess of what they have previously been when conducted as separate enterprises.

The pending proposal for the acquisition of substantially all of the stock of Ford Hopkins calls for a total purchase price of $2,800,000, payable $735,000 upon the signing of a contract and the balance of $2,065,000 over a period of years according to a formula under which there would be paid a minimum of $200,000 a year, plus one-half of the combined net earnings of Ford Hopkins and Stineway in excess of $200,000, before provision for Federal income taxes or depreciation but after certain deductions includ-

Exhibit "C", Annexed to Foregoing Affidavit:

ing any Federal income taxes actually paid during the year. The precise terms and conditions of the purchase have, of course, yet to be worked out but the foregoing represents a broad outline of the proposed transaction.

The cash resources of the Schulte Company, Stineway and Ford Hopkins, and the future earnings of the latter two companies, will be sufficient to finance the purchase (as well as to pay the balance of $420,000 due on April 15, 1954 for purchase of the Stineway stock), except for approximately $350,000, which must be raised in the form of equity capital.

In attempting to accomplish the acquisition of Ford Hopkins, which your management believes would so dramatically advance the interests of your Company, we have sought to find such equity capital. We have succeeded in working out an arrangement with A. C. Allyn and Company, Incorporated, of Chicago, Illinois under which the Allyn Company will purchase 300,000 shares of Schulte common stock at $1.37½ per share or a total of $412,500. The Allyn Company will, in turn, grant participations to a limited number of individuals, all of which is more fully set out in the enclosed Proxy Statement. The stock purchase by the Allyn Company is conditioned upon the successful conclusion of negotiations for the purchase of the Ford Hopkins stock.

For the foregoing reasons, the management believes the increase in the authorized capital stock of the Company and the approval of the proposed stock sale to the Allyn Company is highly desirable. It considers the Company fortunate in being able to attract equity capital to carry out its plan for developing the business of the Company along profitable lines.

The proposed change of name of the Company to General Stores Corporation is designed to reflect the growth of the Company beyond the tobacco shop, which the former

name symbolized, and the launching of a vigorous new enterprise in the chain drug field.

Inasmuch as the votes of two-thirds of the stockholders are required for the approval of the proposal, may we urge you to return the enclosed Proxy to us at your earliest convenience.

Sincerely yours,

N. CLARKSON EARL, JR.,
President

January 18, 1954.

Exhibit "D", Annexed to Foregoing Affidavit.

(193)

GENERAL STORES CORPORATION
(Formerly D. A. Schulte, Inc.)

FORD HOPKINS COMPANY
Drug Stores in Illinois, Indiana,
~~Iowa and Wisconsin~~

STINEWAY DRUG COMPANY
Drug Stores in Chicago

"A. SCHULTE" STORES

GENERAL STORES CORPORATION
(Formerly D. A. Schulte, Inc.)
380 Broadway
New York 13, New York

June 30, 1954

TO OUR STOCKHOLDERS:

Last September I wrote you about the acquisition of Stingway Drug Company, which operates 23 drug stores and 12 franchised Stineway System Stores in metropolitan

Exhibit "D" Annexed to Foregoing Affidavit

Chicago. I pointed out that the purchase was part of an overall plan to acquire independent non-competitive drug chains.

At our stockholders' meeting in February of this year you were acquainted with our efforts to acquire the stock of Ford Hopkins Company, which operates 48 rental drug stores and 3 restaurants, principally in Chicago as well as in other cities in Illinois and in the states of Indiana, Iowa and Wisconsin. Ford Hopkins Company is also the owner of all the stock of Sargent's Drug Store, which operates 5 pharmacies, mainly in the Chicago area.

The acquisition of the Ford Hopkins stock was consummated on May 19, 1954. The purchase price was $2,800,000, of which $735,000 was paid upon the signing of the contract of acquisition. For the balance of the purchase price the Company delivered promissory notes, payable over a period of years according to a formula which is generally based on the earnings of Ford Hopkins and Stineway, with an annual minimum payment of $200,000 beginning in 1955. As security for the balance of the purchase price, all of the stock of Ford Hopkins and Stineway was assigned to Lewis J. Ruskin, as Trustee, with power in the Trustee to vote such stock, subject to certain provisions prescribing the election of representatives of our Company as minority directors of Ford Hopkins and Stineway and the consent of our Company before certain action is taken by either Stineway or Ford Hopkins.

At the time of the Ford Hopkins acquisition, arrangements were made with Ford Hopkins and Stineway providing for servicing of these two chains by our Company for a stipulated commission. Steps have also been taken looking toward unification of the buying, warehousing and distributing operations of Stineway and Ford Hopkins, which should result in economies and increased earnings for the two companies.

Exhibit "D", Annexed to Foregoing Affidavit.

I wish that I could say an encouraging word about the business done by our Schulte-type stores. I have frequently referred in the past to the great difficulties arising from the small size of these stores and the narrow gross profit margin on their staple items, such as cigars, cigarettes, tobaccos and accessories. Under the circumstances existing, it has not been possible to stem the losses from Schulte operations. Indeed, in spite of all the efforts of our management, such losses were on the increase during the early part of this year.

In view of the situation, the Board of Directors has decided to embark upon a program of discontinuing the operation of all the Schulte-type stores. Such a program, which it is contemplated will be completed by the end of this year, presently calls for the sale of the stores wherever possible to individual operators. Your management presently estimates that the Company may sustain substantial losses in the sale of inventory and fixtures, severance pay and other factors involved in the discontinuance of the operations of all the Schulte-type stores. However, if the program is carried out as planned, it will result in the ultimate elimination of operating losses from the Schulte-type stores of our Company. If these difficulties are overcome and the emphasis of our retailing operations is shifted from cigarettes and tobacco into lines of merchandise carrying a substantially higher profit margin, that will be a cause of real gratification to all of us who are interested in the welfare of our Company.

Cordially,

N. C. EARL, Jr.,
President.

Exhibit "D", Annexed to Foregoing Affidavit.

GENERAL STORES CORPORATION
(Formerly D. A. Schulte, Inc.)
380 Broadway
New York 13, New York

June 30, 1954

TO OUR STOCKHOLDERS:

At the annual meeting of the stockholders of General Stores Corporation, held on February 10, 1954, all of the management nominees for directors were elected to serve for a term of one year. The eleven directors elected and the number of votes each received are as follows:

Name	*No. of Votes*
N. Clarkson Earl, Jr.	1,561,508
Selig S. Burrows	1,561,508
Waddill Catchings	1,561,508
Charles A. Clark, Jr.	1,561,508
Joseph B. Hall	1,561,508
Morris E. Jacobs	1,561,508
Morton Jenks	1,561,508
Joseph A. Neff	1,561,408
Arthur N. Pierson, Jr.	1,561,408
Charles F. Ross	1,561,408
Paul J. Timbal	1,561,408

Joseph W. Blumenthal, who was nominated from the floor, received 17,010 votes. All the votes were cast pursuant to the provision for cumulative voting, under which the number of shares voted is multiplied by the number of

directors to be elected, and the total may be voted for one individual or divided among a number of individuals. (Subsequent to the stockholders' meeting, the number of directors was increased from 11 to 12 and John W. Combs was elected an additional director. Some time later, Messrs. Joseph A. Neff and Morris E. Jacobs resigned as directors and were replaced by Messrs. Mortimer M. Kelly, Jr. and Robert E. Woods. Messrs. Combs, Kelly and Woods are Vice Presidents of the Company.)

The proposal to increase the authorized common stock of the Company from 2,315,000 to 3,000,000 shares and to provide for the issuance of the additional 685,000 shares in such manner as shall be determined by the Board of Directors was approved by a vote of 1,552,812 to 33,054.

The proposed agreement between the Company and A. C. Allyn and Company, Incorporated, for the sale by the Company to A. C. Allyn and Company, Incorporated of 300,000 shares of common stock of the Company at $1.37½ per share, in order to finance the purchase of the stock of Ford Hopkins Company, was approved by a vote of 1,453,822 to 37,434. (The sale of the 300,000 shares to A. C. Allyn and Company, Incorporated was not consummated, but the Board of Directors authorized the sale of up to 300,000 shares of the Company's stock to a limited number of persons for investment, at the same price of $1.37½ per share which A. C. Allyn and Company, Incorporated had agreed to pay. The acquisition of the Ford Hopkins Company stock was effected on May 19, 1954; a report concerning such acquisition is contained in the accompanying letter from the President of the Company.)

The proposal to amend the Certificate of Incorporation of the Company to change the name of the Company to General Stores Corporation was approved by a vote of 1,535,057 to 15,109.

Exhibit "D", Annexed to Foregoing Affidavit.

The appointment of S. D. Leidesdorf & Co. as auditors for the current fiscal year was approved by a vote of 1,554,650 to 6,586.

N. Clarkson Earl, Jr., President of the Company, presided at the meeting, and C. Edward Brown, Secretary of the Company, acted as secretary of the meeting. Albert W. Doyle and Howard J. Sinclair, employees of the Chemical Bank & Trust Company, acted as inspectors of election.

The President opened the meeting by making a brief statement in which he reported on the acquisition of the stock of Stineway Drug Company and the proposed acquisition of the stock of Ford Hopkins Company. The President adverted to the low profit margin in cigarettes and the desirability of the move into the chain drug business. The meeting was then thrown open to discussion.

John W. Gilbert took the floor and pointed out the desirability of giving all stockholders an opportunity to participate in offerings of the Company's stock. The President stated that with respect to future transactions the participation of stockholders, wherever practicable, would be taken into consideration.

Further questions of Mr. Gilbert dealt with the business of Stineway Drug Company and the litigation with the Smith brothers. As to the latter, counsel for the Company reported that the trial had begun a few days previously and that there was a possibility that the case would be settled. (Subsequent to the meeting, the case was settled by the payment of $16,500 to Wendell H. Smith, and $18,250 to H. Cornell Smith together with cancellation of a $10,000 note which had been issued by H. Cornell Smith in payment for 10,000 shares of the Company's stock. Wendell H. Smith had sued for $31,384.92 and H. Cornell Smith for $150,000, with interest.)

Exhibit "D", Annexed to Foregoing Affidavit.

Joseph W. Blumenthal inquired about the introduction of more high-profit merchandise in existing Schulte stores. The President pointed out that the small size of these stores presented very serious obstacles. He added that the closing of some of these stores was under active consideration. In this connection the President explained the advantages which could be derived if it were found possible to acquire additional chain drug stores.

The meeting, which had been called to order at 10 A.M., was adjourned at 12:30 P.M.

Stockholders holding 531 shares were present in person. Stockholders owning 1,559,858 shares were represented by management proxies and the holders of 1,085 shares were represented by proxies issued to other individuals.

Very respectfully,

C. EDWARD BROWN,
Secretary.

[fol. 86a] In United States Court of Appeals for the Second Circuit, October Term, 1954

Argued March 18, 1955. Decided April 14, 1955

Docket No. 23557

General Stores Corporation, Debtor-Appellant,

v.

Max Shlensky and Securities and Exchange Commission Appellees

Before: Clark, Chief Judge, Frank, Circuit Judge, and Galston, District Judge.

Appeal from the United States District Court for the Southern District of New York, Edward J. Dimock, Judge.

General Stores Corporation appeals from an order dismissing its petition under Chapter XI of the Bankruptcy Act unless it files an amended petition under Chapter X of the same act. Affirmed.

Melvin Liebowitz, New York City, (Aaron Rosen, Frederic P. Houston, and Otterbourg, Steindler, Houston & Rosen, New York City, on the brief), for debtor-appellant.

A. Alan Reich, New York City (Reich, Peller, Guadagnor & Caine and Howard Shugerman, New York City, on the brief), for appellee Max Shlensky.

William H. Timbers, Gen. Counsel, Securities and Exchange Commission, Washington, D. C. (David Ferber, Spec. Counsel, and Richard V. Baudler and Ezra Weiss, Attys., Securities and Exchange Commission, Washington, D. C., on the brief), for appellee Securities and Exchange Commission.

Max Goldweber, Jamaica, N. Y. (L. J. Weinsheuker and Weinsheuker & Kenner, New York City, on the brief), for Wage Claimants.

[fol. 87a] Leon Singer, New York City (Samuel Blumberg and Blumberg, Singer, Heppen & Blumenthal, New

York City, on the brief), for Creditors of General Stores Corporation.

OPINION April 14, 1955

CRAIG, Chief Judge:

The debtor, General Stores Corporation, filed a petition under Chapter XI of the Bankruptcy Act, 11 U.S.C. § 722, for an arrangement of the debts owed to its unsecured creditors. According to its plan these creditors were to receive the full face amount of their claims over a five-year period. Max Shlensky, a stockholder, challenged the adequacy of the Chapter XI procedure through a show cause order seeking a transfer to Chapter X pursuant to the newly enacted 11 U.S.C. § 728. The Securities and Exchange Commission, being granted leave to intervene, filed a motion to similar effect. Judge Dimock granted this motion and ordered the present petition dismissed unless the debtor within forty days filed an amended petition complying with the requirements of Chapter X. We stayed this order pending our determination of the debtor corporation's appeal. On this appeal the order below is supported by the stockholder and the SEC, while reversal is sought by the debtor and representatives of the general and wage creditors.

The present corporate structure of the debtor corporation is not overly complicated. General Stores Corporation is, however, the corporation formerly known as D. A. Schulte, Inc., whose somewhat checkered financial history is referred to below. At the present time there are two main corporate assets, the cash received from liquidation of the Schulte tobacco stores which were formally the chief source of income, and stock of two wholly-owned subsidiaries, Steinway Drug Company and Ford Hopkins Company. These assets total about $5,000,000. On the other side of the ledger there are about $4,000,000 of liabilities, and a capital account of more than $2,000,000. Half of the liabilities are the unsecured debts here sought to be settled by arrangement. The other liabilities represent the unpaid purchase price of the subsidiary corporations in which the debtor has just recently invested, and these liabilities are secured by the stock of

[fol. 88]

the subsidiaries. The capital account consists of 2,322,422 outstanding shares of $1 par common stock, held by 7,000 stockholders and traded on the American Stock Exchange.

As D. A. Schulte, Inc., General Stores went through a 77B reorganization from 1938 to 1940, in which much of the old common stock turned out to be worthless. Now the new common is again partially under water, and the stockholders are justifiably concerned, for their interests are in no way protected in a Chapter XI proceeding. They fear that the change from Schulte type stores to regular drugstores may only postpone the liquidation or reorganization which may be inevitable; and they wish some assurance of a fair plan now, before the remaining assets are dissipated.

We concur in Judge Dimock's well reasoned opinion that this situation calls for the greater investigation and protection of Chapter X rather than for the informal arrangement of Chapter XI. His decision we think, makes an appropriate evaluation and analysis of the criteria set out in *Mecca Temple of Ancient Arabic Order of Nobles of Mystic Shrine v. Darrock*, 2 Cir., 142 F. 2d 869, certiorari denied 323 U.S. 784, which a majority of this panel think were rather slighted in the more recent decision of *In re Transvision, Inc.*, 2 Cir., 217 F. 2d 243, certiorari denied Feb. 28, 1955; though, as Judge Dimock points out and we discuss below, this case differs markedly from *In re Transvision, Inc., supra*. In our view a widespread stockholder interest in a corporation with such a shaky financial history as this one is in itself sufficient ground for the in-

[fol. 89a] vocation of Chapter X proceedings. Even the unsecured creditors who are urging the reinstatement of the Chapter XI petition may come to regret their decision during the interval of postponed payment, without interest, of their claims. For the present, proceedings are completely in the control of the debtor corporation on whose financial acumen and bookkeeping accuracy must rest the fairness and the feasibility of the proposed arrangement. Too great a public interest is here at stake to allow the present management of the debtor to secure court ratification of such a plan without having available to all parties the disinterested appraisal and judgment of the

Securities and Exchange Commission. It is noteworthy that a corporation of this size is one for which SEC intervention is mandatory in a Chapter X proceeding. Bankruptcy Act § 172, 11 U.S.C. § 572.

Hence this is emphatically not the small corporation in which the calculated risk of the informal Chapter XI proceedings is warranted. It does not fall into the category of tightly knit structures where the subordinate creditors and stockholders are the management of the business and where the preservation of going concern value through their continued management of the business may compensate for reduction of creditor claims without alteration of management interests. *Securities and Exchange Commission* v. *U. S. Realty & Improvement Co.*, 310 U.S. 434, 454. The criteria for choice between Chapter XI and Chapter X enunciated in that case were written into the Bankruptcy Act of the enactment of § 328, 11 U.S.C. § 728, in 1952. See 1952 U. S. Code Cong. & Adm. News 1979-1980. We are content to apply them here.

The contrast between General Stores Corporation, a multimillion dollar corporation with 7,000 stockholders whose stock is actively traded on a leading stock exchange of the country, and *In re Transvision, Inc.*, *supra*, 2 Cir. [fol. 90a] 217 F. 2d 243, 246, 247, is well pointed up by Judge Dimock, who says: "In the Transvision case the debtor had outstanding 385,000 shares of common stock and 17731/2 shares of preferred. All were in the hands of management interests except 135,000 shares of common held by 425 investors. It was not listed on any exchange. The debtor's liabilities were about $700,000 and its assets about $1,000,000." So in that case Judge Sugarman exercised his discretion in denying transfer to Chapter X, a factor emphasized in the *U. S. Realty* case, *supra*, 310 U.S. 434, 455-457, and our brothers sustained him. The inference seems clear to us that upon their reasoning, they would have sustained Judge Dimock's reasoned exercise of discretion here. We are bound to add, however, that their stress upon such criteria as the proposal of "relatively simple plans" or a "reasonable likelihood that the desired financial recovery will be effected without unduly prejudicing the rights of any interested parties" and

their suggestion that a later showing of "irregularities of management" may then lead to an order of transfer do not seem to us realistic or operable in the premises. Rather, following the *U.S. Realty* and *Mecca Temple* cases, the court must evaluate the sufficiency of the remedy for the apparent need and must do so, in order to afford any protection at all adequate, at the beginning of the proceedings and before committing steps of a contrary nature have been taken. This is the course which was taken below. Its order must therefore stand, except of course for the setting of a new date within which the debtor or its creditors may file an amended petition under Chapter X if they so choose. Our stay will remain in effect until the district court acts.

Order affirmed; action remanded.

[fol. 91a] FRANK, Circuit Judge, concurring:

I agree with all that Judge Clark says. However, while he may well not have intended to go beyond severely restricting the recent decision of this court in In re Transvision, Inc., 217 F. (2d) 243 (C. A. 2), his opinion may perhaps be read as intending to overrule it. I think it desirable, therefore, to say that I am not ready to go that far, although, had I been sitting in the panel which decided that case, I would have dissented. I would say here merely that I think the rationale of the Transvision decision should be limited to a case where the facts are in most respects similar, i. e., a case where (a) but a relatively small proportion of the securities is publicly held by a small number of investors, (b) none of the securities was listed on any exchange, (c) the assets do not exceed approximately $1,000,000, and (d) there are merely the faintest suspicions raising questions about the conduct of the management.

[fol. 92a] GIBSON, District Judge (dissenting):

I do not believe that Securities and Exchange Commission v. United States Realty & Improvement Co., 310 U. S. 434, compels an affirmance of the order below. Rather the circumstances presented in the present proceeding are essentially, in principle, the same as are set forth in In re Transvision, Inc., 217 Fed. 2d 243. Judge Medina, in the

Transvision opinion, weighed both Securities Commission v. United States Realty Co., supra, and Mecca Temple, etc. v. Davrock, 142 Fed. 2d 869, but observed:

> "Nonetheless, the scope of the permissible inquiry into the propriety of proceeding under either chapter is not susceptible of ready definition solely in terms of the existence or non-existence of public stockholders."

Clearly herein there are presented but two classes of interests: (1) that of the stockholders; (2) that of unsecured creditors. It cannot be too strongly emphasized that neither the company itself nor its unsecured creditors seek a reorganization. A single stockholder and the Securities and Exchange Commission nevertheless intervene to thwart the plan of arrangement submitted by the corporation to its unsecured creditors which would enable those [fol. 93a] creditors to receive a full 100% payment of their claims.

What is to be effected by a plan or reorganization? What is there to reorganize?

An anomolous situation arises because if the debtor had moved in the first instance under Chapter 10, it is very doubtful whether in its petition it could have met the requirements of Section 530, Title 11 of Chapter 10. In that event it would seem that the provisions of Section 547 of Title 11, Chapter 10, would apply. That section provides that when a petition filed under Chapter 10 discloses that adequate relief could be obtained by the debtor under Chapter 11, an amendment to comply with the requirements of Chapter 11 could be made. See John Hancock Mut. Life Ins. Co. v. Casey, 141 Fed. 2d 104.

Acceptance of the plan of arrangement is on its face all that the company needs to carry on its affairs. The wage earners who fall among the unsecured creditors, and who are eager to have prompt payment, certainly will suffer delay if proceedings are had under Chapter 10.

In the motion for leave to intervene made by the Securities and Exchange Commission it is alleged that "if the proposed arrangement is confirmed and the proceedings are not dismissed, the interests of investors in this proceed- [fol. 94a] ing will be improperly affected." But there is

nothing in the record before this court which sustains that allegation.

The debtor has no funded debts by way of debentures or certificates of indebtedness of any kind—bonds, mortgages, notes or obligations of like character, sold, distributed or in the hands of the general public. So much appears in the affidavit of the president of the debtor. As I have intimated, the proposed plan of arrangement does not seek to modify in any form whatsoever the capital stock of the debtor.

The order under review, if the debtor desires to have the sanction of the Bankruptcy Act, leaves no alternative but to endeavor to comply with the requirements of Chapter 10. Failing that, it is faced with the necessity of endeavoring to settle with its creditors out of court. In doing so it runs the hazard of committing an act of bankruptcy which might enable some creditors to file a petition in ordinary bankruptcy. So liquidation of the debtor would ensue. Chapter 10, as I have stated, is essentially designed to enable a debtor to work out a plan of reorganization. Historically its immediate predecessor was Chapter 77B of the Bankruptcy Act, and that in turn followed the old equity receivership, the outstanding characteristic of which was [fol. 95a] to seek a plan of reorganization of vested and conflicting interests.

It would seem to be sound common sense to leave the management of the business to the judgment of its officers and directors. There is not the slightest suggestion of the violation of any state law. Indeed if stockholders should determine that there has been bad management or misjudgment or fraud, ample relief is possible under the corporation laws of the State of New York, the domicile of the debtor.

For the foregoing reasons I feel impelled to dissent.

[fol. 96a] In United States Court of Appeals for the Second Circuit

In the Matter of General Stores Corp., Debtor Appellant

Appeal from the United States District Court for the Southern District of New York

Judgment—April 14, 1955

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed and action remanded in accordance with the opinion of this Court.

Further ordered that the stay heretofore granted will remain in effect in accordance with the opinion of this Court until the District Court acts.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

(S.) A. Daniel Fusaro, Clerk.

[fol. 97a] [File endorsement omitted.]

[fol. 98a] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 99a] Supreme Court of the United States, October Term, 1955

No. 170

[Title omitted]

Order Allowing Certiorari. Filed October 10, 1955.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

No.

IN THE

Supreme Court of the United States

OCTOBER TERM 1955

IN THE MATTER OF PROCEEDINGS FOR AN ARRANGEMENT UNDER CHAPTER XI OF THE BANKRUPTCY ACT OF

GENERAL STORES CORPORATION,

Debtor-Petitioner,

v.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS COMMITTEE AND WAGE CLAIMANTS,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

In the Matter of Proceedings for an Arrangement under Chapter XI of the Bankruptcy Act of

GENERAL STORES CORPORATION,

Debtor-Petitioner,

v.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS COMMITTEE and WAGE CLAIMANTS,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

General Stores Corporation prays that a Writ of Certiorari be issued to review the judgment of the United States Court of Appeals for the Second Circuit, dated April 14, 1955, which affirmed by a divided Court (2 to 1 with three separate opinions) the judgment entered on March 7, 1955 by the United States District Court for the Southern District of New York. Although debtor seeks, pursuant to Chapter XI of the Bankruptcy Act to compose its general unsecured trade and commercial debts, none of which is evidenced by any publicly held security, a single stockholder of the debtor and the Securities and Exchange Commission have nevertheless thwarted the proceeding by

obtaining a judgment dismissing the arrangement proceedings under Chapter XI unless the petition is amended to comply with the provisions for reorganization under Chapter X.

Opinions Below

The opinions of the Court of Appeals (Appendix *infra* pp. 1a-8a) are not yet officially reported. The opinion of the District Court (Record pp. 6a-11a) is reported at 129 F. Supp. 801 and decision denying re-argument (R. 12a) is not officially reported.

Jurisdiction

The judgment of the Court of Appeals was entered on April 14, 1955 (App. *infra* p. 8a). Stay of the mandate for thirty days pending application for Writ of Certiorari in this Court was ordered by the Court of Appeals on April 27, 1955 and renewed for an additional thirty days on May 26, 1955 (App. *infra*, p. 10a).

The jurisdiction of this Court is invoked under 28 U. S. C. 1254 (1). See also Sec. 24 (c) of the Bankruptcy Act (11 U. S. C. 47 (c)).

Questions Presented

1. Whether a corporate debtor can be denied the right to proceed under Chapter XI where it seeks merely an arrangement or composition of its general unsecured trade and commercial debts not evidenced by any publicly held securities, and where in no sense does it seek a corporate reorganization or any change whatsoever in its capital structure or its publicly-held and listed common stock.

2. Whether a stockholder owning less than 2/10ths of one percent of the common stock of the debtor, joined by the Securities and Exchange Commission, can compel transfer of such an arrangement proceeding initiated under Chapter XI to a reorganization proceeding under Chapter X in the total absence of even a suggestion of wrongs done stockholders or other persons. May the Court compel the debtor to forego the economies of Chapter XI for the elaborate, expensive and unnecessary proceedings under Chapter X merely on the request of the Securities and Exchange Commission for amplified investigatory authority, without evidence in the record of some showing of wrong done or contemplated, or substantial question of the fairness or feasibility of the arrangement proposed pursuant to Chapter XI?

3. Whether Chapters X and XI are mutually exclusive and on what basis. Within this question is whether or not Congress intended to prevent debtors from employing the drawn out, elaborate and expensive procedures of Chapter X, when all that such debtors sought or required was an arrangement or composition of their unsecured trade and commercial debts; similarly, whether Congress had not intended by removing the "fair and equitable" rule by the 1952 amendment to Chapter XI, that Chapter XI provided the only proper procedure for a composition with unsecured trade and commercial creditors while continuing the interest in the stockholders unchanged.

Statutes Involved

Pertinent provisions of Chapters X and XI are set forth in the Appendix, *infra*, pp. 11a-15a.

Statement

On October 18, 1954 General Stores Corporation, the debtor, filed a petition in the District Court for the Southern District of New York in accordance with the provisions of Sec. 322* of Chapter XI of the Bankruptcy Act for the reason that it was then unable to pay its debts as they matured. It proposed an arrangement of its general unsecured trade and commercial debts (R. 13a), none of which is evidenced by any publicly held security (R. 43a).

A summary of its assets and liabilities attached to the petition showed total assets in excess of total liabilities by $1,600,000. The proposed arrangement would have compulsory effect only on the general unsecured creditors. Under this plan they would receive 100% of their claims, 20% on confirmation of the plan and 20% annually thereafter.** Creditors entitled to statutory priority were to be paid in full (R. 44a).

The general unsecured creditors are: (a) those who are owed for merchandise, services, supplies, rents and salaries, shown in the debtor's Statement of Affairs (R. 41a) to aggregate $524,970.09; and (b) debtor's wholly owned subsidiary, the Stineway Drug Company, on notes aggregating $1,310,000.00 (R. 42a).

The debtor has no funded debts by way of debentures, no certificates of indebtedness of any kind, no bonds,

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* 11 U. S. C. § 722; 52 Stat. 907.

** Arrangement plans may (and they usually are) altered or modified at various stages of a proceeding up to the time of confirmation as authorized by Sec. 363 (11 U. S. C. 763; 52 Stat. 911) of the Bankruptcy Act.

mortgage certificates, notes or obligations of like character, sold, distributed or in the hands of the general public (R. 42a). No secured obligation and no securities of any kind are affected by or intended to be modified in any manner or form by the arrangement (R. 43a).

The arrangement does not affect or seek to modify in any manner or form the capital stock of the debtor corporation. The authorized capital stock consists of 3,000,000 shares of common stock of the par value of $1.00 each and all of one class, of which there were issued and outstanding at the time of the petition 2,053,922 shares (R. 43a).

At present the debtor has two principal corporate assets. The first is the cash received from the liquidation of the Schulte Tobacco Stores, from all of which debtor has withdrawn during the pendency of these proceedings; debtor has liquidated its inventories and practically all of its tangible assets.

The second asset is the debtor's equity in the capital stock of the Stineway Drug Company and the Ford Hopkins Company, both wholly owned by the debtor. As a going concern, the debtor also has a valuable asset in a carry forward operating tax loss (R. 66a-67a).

The Intervention to Dismiss Proceedings

On November 9, 1954, upon the petition of Max Shlensky, an alleged owner of 3,000 shares (less than 2/10ths of one percent of the common stock of the debtor), the District Court issued an order that the debtor and the Securities and Exchange Commission show cause why the proceedings for an arrangement under Chapter XI should not be dismissed unless within a time fixed by the Court

the petition be amended to comply with the requirements of Chapter X for the filing of a petition for reorganization under said Chapter (R. 17a). The Securities and Exchange Commission cross-moved for leave to intervene and for the same relief requested by Max Shlensky (R. 23a-28a).

On these motions the Court was asked to consider facts which the debtor considers to be irrelevant and immaterial to its right to proceed under Chapter XI. For example:

(a) The outstanding stock is held by some 7,000 stockholders, is traded on the American Stock Exchange, and is in part registered with the Securities and Exchange Commission (R. 30a).

(b) The Corporation, organized in 1915 and formerly known as D. A. Schulte, Inc., was in a Section 77-B reorganization proceeding from 1938 to the consummation of a plan on April 31, 1940. During the war years it enjoyed a profitable operation but in the post-war period its volume began to fall, its profit became narrower, attempts at modernization of the Schulte type chain of stores failed, and the debtor embarked upon a program of discontinuing the operation of its Schulte type stores and purchased the outstanding capital stock of Stineway Drug Company and The Ford Hopkins Company, which owned chains of retail stores in Chicago and mid-western states and supplied other stores (R. 31a-33a).

(c) In November, 1952 the Corporation registered 741,647 shares of its common stock with the Securities and Exchange Commission and its original Registration Statement dated November 12, 1952, had been periodically re-

vised, the last revision being dated July 21, 1954 (R. 31a). Under date of September 20, 1953 the stockholders were notified of the acquisition of the Stineway Drug Company and the reasons therefor (R. 70a-72a). In connection with the annual meeting of stockholders held February 10, 1954 the Corporation solicited proxies and sent out a proxy statement, as required by the rules of the Securities and Exchange Commission, which notified the stockholders of the Corporation's intention to purchase substantially all of the outstanding capital stock of Ford Hopkins Company (R. 67a and 73a-79a). Stockholders endorsed the program by 1,453,822 to 37,434 (R. 83a). The consummation of the Ford Hopkins purchase by the Corporation was reported to its stockholders by letter of June 30, 1954 (R. 79a-85a), and as pointed out, the Corporation's Registration Statement with the Securities and Exchange Commission was then amended as of July 21, 1954 (R. 31a).

The matter was heard by the Court, Dimock, D.J., and an opinion rendered on January 24, 1955 (R. 6a-12a). A motion for re-argument was denied (R. 12a), and an order was entered on March 7, 1955 granting the Securities and Exchange Commission leave to intervene and dismissing the proceedings for an arrangement under Chapter XI unless on or before March 15, 1955 the debtor filed an amended petition, or before such date a creditors' petition be filed under Chapter X for a reorganization (R. 3a-5a). This is the judgment which has been affirmed by the Court of Appeals except for the appellate court's direction to the District Court to set a new date within which the debtor or its creditors may file an amended petition under Chapter X if they so choose (App. pp. 5a and 9a).

Reasons for Granting the Writ

Substantial reasons for granting review and reversing the judgment below are expressed by Galston, D. J. in his dissenting opinion (App. pp. 6a-8a).

The decision below by a divided Court has decided an important question of federal law which has not been, but should be, settled by this Court, to wit: Whether the remedies offered in Chapter XI to corporate debtors may, in the interest of stockholders be denied to certain corporate debtors because they are "large" and their stock publicly held.

This Court's decision in the *U. S. Realty* case[*] (the only opinion by this Court relied on by the Courts below) had nothing to do with the foregoing question. The debtor's plan in that case expressly diminished its guarantee of mortgage certificates held by public investors and the Securities and Exchange Commission intervened in the interests of such creditors. This Court's decision was based on considerations of "the best interests of the creditors" and not the interests of stockholders. This Court has never passed on the interests of stockholders in a Chapter XI proceeding, particularly after the 1952 amendments to that chapter.

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[*] *Securities and Exchange Commission* v. *U. S. Realty & Improvement Co.*, 310 U. S. 434 (1940), where the Court noted that its decision was to be limited to the facts in that case, and said at page 454: "While this means that arrangements of unsecured debts of corporations like respondent, may not be 'in the best of interest of creditors' and 'feasible' under Chapter XI, it does not mean that there is no scope for application of that chapter in many cases where the debtor's financial business and corporate structure differ from respondent's."

2. The Court of Appeals of the Second Circuit has here rendered a decision in conflict with a decision of the Court of Appeals of the First Circuit in the *John Hancock* case* on the same basic issue here presented as to what makes Chapters X and XI mutually exclusive. The First Circuit dismissed a Chapter X proceeding and held that it is the relief requested by the debtor which determines the proper chapter (141 Fed. 2d at 107). The Court below in dismissing the Chapter XI proceeding, has rejected that rule and instead has applied a rule involving factors not suggested by the statute, among which are whether the debtor is large and whether its stock is publicly held.

3. Confusion exists among the panels of the Second Circuit, as is evidenced in the opinions below with reference to the Court's previous decision in the *Transvision* case**. Although none of the debts sought to be arranged in the *Transvision* case was evidenced by a publicly held security, the opinion in the *Transvision* case has been criticized by a majority of the panel in this case for "slighting" the *Mecca Temple**** decision. This is hardly fair to the former panel of the Court since the *Mecca Temple* case has nothing to do with our problem. Mecca Temple was a membership corporation and of course no public stockholders were involved. The Securities and Exchange Commission intervened in that case in the in-

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* *John Hancock Mut. Life Ins. Co.* v. *Casey*, 141 Fed. 2d 104 (1940); cert. den. 323 U. S. 713.

** *In re Transvision, Inc.*, 217 Fed. 2d 243; cert. den. —— U. S. ——; 75 Sup. Ct. 440; February 28, 1955.

*** *Mecca Temple* v. *Darrock*, 142 Fed. 2d 869 (1944); cert. den. 323 U. S. 784.

terests of debtor's bondholders who were members of the public and as public security holders directly affected by the proposed arrangement. In short, the *Mecca Temple* case merely follows on the facts and reasoning of the *U. S. Realty* case; both involved an unfair and inequitable plan directly prejudicing public security holders *as creditors*. In no sense can either decision be properly applied to the present case.

4. It has been recognized that Chapter XI of the Bankruptcy Act contains no limitation as to the type of debtor entitled to relief thereunder, that is, whether large or small, with stock privately or publicly held. This Court, in the *U. S. Realty* case said:

> "We find in neither chapter (X or XI) any definition or classification which would enable us to say that a corporation is small or large, its securityholders few or many, or that its securities are 'held by the public', so as to place the corporation exclusively within the jurisdiction of the Court under one chapter rather than the other." (310 U. S. at 447)

In the face of unanimity of comment** that the statute as written does not support a distinction between large and small debtors with stock privately or publicly held, the Court below has nevertheless applied a distinction derived from the language of this Court in an entirely different

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* See Sec. 306(3) in Appendix, *infra*, p. 13a.

** 48 Yale Law Journal, p. 1334 at 1364 (1939 and before the *U. S. Realty* case);

40 Columbia Law Review, 1245 at 1251 (1940, commenting on the *U. S. Realty* case);

Also in re *Transvision, Inc.*, 419 F. Supp. 134 at 135.

context (*U. S. Realty*). The confusion thus created should be removed by further decision of this Court.

5. The Bankruptcy Act exhibits the Congressional intent to prevent the use of Chapter X by debtors who could obtain adequate relief under Chapter XI*. Section 130(7) of the Act** requires a petitioner under Chapter X to show specific facts why it could not obtain adequate relief under Chapter XI, and Section 146 provides that a debtor's petition under Chapter X shall be deemed not to be filed in good faith where the debtor could have obtained adequate relief under Chapter XI.* If a debtor's petition in Chapter X has been improperly filed "because adequate relief can be obtained *by the debtor* under Chapter XI", the petition shall be dismissed pursuant to Section 141 or the debtor may amend pursuant to Section 147 so as to comply with the requirements of Chapter XI. Congress has thereby forbidden the use of the extensive, elaborate and expensive procedures of Chapter X*** where all that is required by a debtor is a composition with general unsecured trade or commercial creditors. At the same time, Congress has encouraged transfer of proceedings which are improperly initiated in Chapter X to the proper chapter, namely Chapter XI.

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* *In re Transvision, Inc.*, 217 Fed. 2d 243 at 246.

** All sections of the Bankruptcy Act cited herein are printed seriatim in the Appendix, *infra*.

*** Trustee, S. E. C. Intervention, Reorganization Manager, Creditors' Committees, Stockholders' Committees, their respective Counsels, their respective Reports, their fees and allowances, etc., described as "detailed and cumbersome", 310 U. S. at 464, and "elaborate investigatory and protective procedures", 217 Fed. 2d at 246.

The statute contains all of the bases for concluding that Congress did not intend to permit debtors to engage themselves in the extensive procedures which had developed under former Section 77-B and incorporated and embellished in the Chandler Act, Chapter X, when all that such debtors required was the composition previously available under Section 12 of the Bankruptcy Act of 1898 as re-enacted and improved in the Chandler Act, Chapter XI.*

6. The 1952 amendments to Chapter XI constitute reiterations by Congress, after the *U. S. Realty* case, that Chapter XI shall be *more available* to debtors and more like the old composition Section 12 of the Bankruptcy Act of 1898, and shall not be restricted to certain debtors.

(a) By amending Section 366 and deleting the previous requirement that arrangements be "fair and equitable", Congress has corrected any impression that might theretofore had existed** that Chapter XI was a descendant of the old equity receivership or that the equitable principles of the *Boyd* case*** should apply to a proposed composition under Chapter XI. Although formerly, the interests of stockholders, as distinguished from the interests of the

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* Legislative history has been cited by both sides to the controversy although Mr. Justice Roberts said that it furnishes but the scantiest support to the Commission's contention and he reviewed the history (310 U. S. 434 at 465, *et seq.*).

** See this Court's opinion in the *U. S. Realty Company* case, 310 U. S. 434 at 457, quoted *infra* in the note on page 14 and compare Judge Clark's opinion in the present case (App. p. 4a) that the 1952 amendment wrote into the Bankruptcy Act the previous opinion of this Court.

*** *Northern Pacific Ry. Co.* v. *Boyd*, 228 U. S. 482 as applied in *Securities and Exchange Commission* v. *U. S. Realty & Improvement Co.*, 310 U. S. 434 at 453.

debtor, were said to be involved in the proceedings under Chapter XI, the 1952 amendment to Section 366 makes crystal clear that compositions recognized under Chapter XI constitute a negotiation between a debtor and its creditors and that the basic requisite for confirmation of a plan is that it be "for the best interests of the creditors."

(b) By adding in 1952 the new Section 328, Congress avoided the risk that previously attended debtors commencing proceedings in Chapter XI which might therefore have been dismissed because the wrong chapter had been chosen. Now none of the interests and priorities which are created by the commencement of proceedings is lost since debtor may transfer proceedings to Chapter X with the same facility which Congress originally provided in Section 147 with respect to proceedings initiated in Chapter X.

The mere procedural correction effected by new Section 328 permitting any party in interest to move for a transfer to Chapter X and to permit the proceedings otherwise to continue uninterrupted, is certainly no codification by Congress of criteria expressed in the *U. S. Realty* case on the choice between Chapter XI and Chapter X.* Nothing in Section 328 bears on criteria for determining such choice or confers discretion in the Court to determine the choice.

To the contrary, by the 1952 amendments, Congress has denied that Chapter XI bears any relationship to the original equity receivership proceedings in the Federal court. Congress has, with respect to Chapter XI, and in unmistakable terms, "reversed on the dissenting opinion" that:

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* Cf. Clark, C.J., below, Appendix, p. 3a.

"The legislature has specified who is entitled to the relief provided by the statute and in what circumstances. The court has no power to refuse that relief on the ground that some other relief would better serve the purpose. What is meant by the statement that a court of bankruptcy is a court of equity is that its function is to make an equitable distribution of the estate among the creditors, but the principle has not been applied in the sense that the court may, in its better judgment, refuse to award the relief which Congress has accorded the bankrupt."

7. The Court below, in attempting to apply equitable discretion where there is no basis for such discretion in fact or law, has departed far from the accepted and usual course of judicial proceedings. The Court's construction of its powers under Chapter XI of the Bankruptcy Act is in violation of the supreme constitutional right in Congress to establish uniform laws on the subject of Bankruptcies in particular, and in general, to have all the legislative Powers of the federal government.**

(a) This Court, in the *U. S. Realty* case, and the Court below in the *Mecca Temple* case, were called upon to act in a Chapter XI proceeding in the interests of creditors who were public security holders and were directly affected by proposed arrangements which were manifestly *unfair* and *inequitable*. In the present case, there has been no

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* By Mr. Justice Roberts, in *Securities and Exchange Commission* v. *U. S. Realty & Improvement Co.*, 310 U. S. 434, [illegible] 458; his opinion is in contrast to the prevailing opinion at 457, "We cannot assume that Congress has disregarded well settled principles of equity, the more so, when Congress itself has provided that the relief to be given shall be 'fair and equitable and feasible.'" Congress, in 1952, corrected the prevailing assumption by deleting "fair and equitable" from Chapter XI.

** U. S. Constitution, Art. I, Sections 1 and 8.

charge, much less proof, that there is anything unfair or inequitable about the debtor's proposed arrangement, or that any violation of stockholders' rights exists* which would warrant equitable intervention against the effect of the plain language of statutory law. No factual reason has been shown by the intervenors or by the courts below which supports a transfer to Chapter X.

(b) The jurisdiction of the court, extended by the 1952 amendment to act upon the application of the Securities and Exchange Commission or any party in interest to dismiss proceedings under Chapter XI unless the petition be amended to comply with the requirements of Chapter X, is not based on equity but rather on statutory law. There is no grant of discretion; rather there is the requirement of a finding of fact and law within the statutory framework of Chapter XI. The Judge may direct a dismissal only:

> "if he finds that the proceedings should have been brought under Chapter X."**

(c) No statutory basis has been found. Instead, the Court below has assumed that stockholders of the debtor, as distinguished from the debtor itself, are "affected"*** by the proposed arrangement and merely on the intervention of one stockholder with less than two-tenths of one percent of the stock, has assumed stockholders are "concerned", "fear" the future and "wish some assurance" not obtainable in Chapter XI.**** This flies in

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* See opinion of Galston, D.J., Appendix, *infra*, pp. 7a and 8a.

** Bankruptcy Act, Sec. 328 added 1952.

*** Congress never envisioned that stockholders would be affected by a composition and therefore, made express provision only for creditors in Section 308; cf. Chapter X, Sec. 107 (11 U. S. C. 507; 52 Stat. 884).

**** Clark, C.J., Appendix, p. 3a.

the face of common knowledge that stockholders "stand to gain by the forebearance of the unsecured trade and commercial creditors contemplated by the arrangement."* There is no statutory basis for the Court's concern.

(d). Although borrowing from the "equitable doctrine" applied in the *U. S. Realty* and *Mecca Temple* cases, the Court below has failed to find any equitable considerations in this case, that is, even if such equitable doctrine were applicable. No such "equitable doctrine" has ever been applied when there are no creditors who are public security holders, within the jurisdictional concern of the Securities and Exchange Commission.

8. No opposition to this Court's review should be expected from the respondents in view of the representations to this Court by the Securities and Exchange Commission as to the public importance of the questions herein involved.** The questions presented not only seriously affect the Securities & Exchange Commission's functions under the Bankruptcy Act but, more important, affect the rights of all financially embarassed stock corporations whose stock is publicly held. The Bankruptcy Court and its Referees and the Bar require a definitive ruling on the meaning of the 1952 amendments to Chapter XI, that is, whether such corporations are entitled to compose their general unsecured trade and commercial debts in Chapter XI or whether under the Act as thus amended they can be forced to reorganize through Chapter X in any case in which the Securities & Exchange Commission decides to intervene.

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* In re *Transvision, Inc.*, 119 F. Supp. 134 at 137.

** Securities and Exchange Commission petition for certiorari in re *Transvision, Inc.*, pp. 4, *et seq.*

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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June 20, 1955.

Opinion of Court of Appeals

United States Court of Appeals for the Second Circuit

October Term, 1954

No. 261

Argued March 18, 1955. Decided April 14, 1955.

Docket No. 23557

General Stores Corporation, Debtor-Appellant

v.

Max Shlensky and Securities and Exchange Commission, Appellees

Before Clark, Chief Judge, Frank, Circuit Judge, and Galston, District Judge.

Appeal from the United States District Court for the Southern District of New York, Edward J. Dimock, Judge.

General Stores Corporation appeals from an order dismissing its petition under Chapter XI of the Bankruptcy Act unless it files an amended petition under Chapter X of the same act. Affirmed.

Melvin Liebowitz, New York City (Aaron Rosen, Frederic P. Houston, and Otterbourg, Steindler, Houston & Rosen, New York City, on the brief), for debtor-appellant.

A. Alan Reich, New York City (Reich, Peller, Guadagno & Caine and Howard Sog Shugerman, New York City, on the brief), for appellee Max Shlensky.

William H. Timbers, Gen. Counsel, Securities and Exchange Commission, Washington, D. C. (David Ferber, Spec. Counsel, and Richard V. Bandler and Ezra Weiss, Attys., Securities and Exchange Commission, Washington,

D. C. on the brief), for appellee Securities and Exchange Commission.

Max Goldweber, Jamaica, N. Y. (L. J. Weinshenker and Weinshenker & Kenner, New York City, on the brief), for Wage Claimants.

Leon Singer, New York City (Samuel Blumberg and Blumberg, Singer, Heppen & Blumenthal, New York City, on the brief), for Creditors of General Stores Corporation.

CLARK, Chief Judge: The debtor, General Stores Corporation, filed a petition under Chapter XI of the Bankruptcy Act, 11 U. S. C. Sec. 722, for an arrangement of the debts owed to its unsecured creditors. According to its plan these creditors were to receive the full face amount of their claims over a five-year period. Max Shlensky, a stockholder, challenged the adequacy of the Chapter XI procedure through a show cause order seeking a transfer to Chapter X pursuant to the newly enacted 11 U. S. C. § 728. The Securities and Exchange Commission, being granted leave to intervene, filed a motion to similar effect. Judge Dimock granted this motion and ordered the present petition dismissed unless the debtor within forty days filed an amended petition complying with the requirements of Chapter X. We stayed this order pending our determination of the debtor corporation's appeal. On this appeal the order below is supported by the stockholder and the SEC, while reversal is sought by the debtor and representatives of the general and wage creditors.

The present corporate structure of the debtor corporation is not overly complicated. General Stores Corporation is, however, the corporation formerly known as D. A. Schulte, Inc., whose somewhat checkered financial history is referred to below. At the present time there are two main corporate assets, the cash received from liquidation of the Schulte tobacco stores which were formerly the chief source of income, and stock of two wholly-owned subsidiaries, Stineway Drug Company and Ford Hopkins Company. These assets total about $5,000,000. On the

other side of the ledger there are about $4,000,000 of liabilities and a capital account of more than $2,000,000. Half of the liabilities are the unsecured debts here sought to be settled by arrangement. The other liabilities represent the unpaid purchase price of the subsidiary corporations in which the debtor has just recently invested, and these liabilities are secured by the stock of the subsidiaries. The capital account consists of 2,322,422 outstanding shares of $1 par common stock, held by 7,000 stockholders and traded on the American Stock Exchange.

As D. A. Schulte, Inc., General Stores went through a § 77B reorganization from 1938 to 1940, in which much of the old common stock turned out to be worthless. Now the new common is again partially under water, and the stockholders are justifiably concerned, for their interests are in no way protected in a Chapter XI proceeding. They fear that the change from Schulte type stores to regular drugstores may only postpone the liquidation or reorganization which may be inevitable; and they wish some assurance of a fair plan now, before the remaining assets are dissipated.

We concur in Judge Dimock's well reasoned opinion that this situation calls for the greater investigation and protection of Chapter X rather than for the informal arrangement of Chapter XI. His decision, we think, makes an appropriate evaluation and analysis of the criteria set out in *Mecca Temple of Ancient Arabic Order of Nobles of Mystic Shrine* v. *Darrock*, 2 Cir., 142 F. 2d 869, certiorari denied 323 U. S. 784, which a majority of this panel think were rather slighted in the more recent decision of *In re Transvision, Inc.*, 2 Cir., 217 F. 2d 243, certiorari denied Feb. 28, 1955, though, as Judge Dimock points out and we discuss below, this case differs markedly from *In re Transvision, Inc., supra.* In our view a widespread stockholder interest in a corporation with such a shaky financial history as this one is in itself sufficient ground for the invocation of Chapter X proceedings. Even the unsecured

creditors who are urging the reinstatement of the Chapter XI petition may come to regret their decision during the interval of postponed payment, without interest, of their claims. For the present proceedings are completely in the control of the debtor corporation on whose financial acumen and bookkeeping accuracy must rest the fairness and the feasibility of the proposed arrangement. Too great a public interest is here at stake to allow the present management of the debtor to secure court ratification of such a plan without having available to all parties the disinterested appraisal and judgment of the Securities and Exchange Commission. It is noteworthy that a corporation of this size is one for which SEC intervention is mandatory in a Chapter X proceeding. Bankruptcy Act § 172, 11 U. S. C. § 572.

Hence this is emphatically not the small corporation in which the calculated risk of the informal Chapter XI proceedings is warranted. It does not fall into the category of tightly knit structures where the subordinate creditors and stockholders are the management of the business and where the preservation of going concern value through their continued management of the business may compensate for reduction of creditor claims without alteration of management interests. *Securities and Exchange Commission* v. *U. S. Realty & Improvement Co.*, 310 U. S. 434, 454. The criteria for choice between Chapter XI and Chapter X enunciated in that case were written into the Bankruptcy Act by the enactment of § 328, 11 U. S. C. § 728, in 1952. See 1952 U. S. Code Cong. & Adm. News 1979-1980. We are content to apply them here.

The contrast between General Stores Corporation, a multimillion dollar corporation with 7,000 stockholders whose stock is actively traded on a leading stock exchange of the country, and *In re Transvision, Inc., supra*, 2 Cir., 217 F. 2d 243, 246, 247, is well pointed up by Judge Dimock, who says: "In the Transvision case the debtor had outstanding 385,000 shares of common stock and 1773½ shares of preferred. All were in the hands of management in-

terests, except 135,000 shares of common held by 425 investors. It was not listed on any exchange. The debtor's liabilities were about $700,000 and its assets about $1,000,000." So in that case Judge Sugarman exercised his discretion in denying transfer to Chapter X—a factor emphasized in the *U. S. Realty* case, *supra*, 310 U. S. 434, 455-457—and our brothers sustained him. The inference seems clear to us that upon their reasoning they would have sustained Judge Dimock's reasoned exercise of discretion here. We are bound to add, however, that their stress upon such criteria as the proposal of "relatively simple plans" or a "reasonable likelihood that the desired financial recovery will be effected without unduly prejudicing the rights of any interested parties" and their suggestion that a later showing of "irregularities of management" may then lead to an order of transfer do not seem to us realistic or operable in the premises. Rather, following the *U. S. Realty* and *Mecca Temple* cases, the court must evaluate the sufficiency of the remedy for the apparent need and must do so, in order to afford any protection at all adequate, at the beginning of the proceedings and before committing steps of a contrary nature have been taken. This is the course which was taken below. Its order must therefore stand; except of course for the setting of a new date within which the debtor or its creditors may file an amended petition under Chapter X if they so choose. Our stay will remain in effect until the district court acts.

Order affirmed; action remanded.

FRANK, Circuit Judge, concurring:

I agree with all that Judge Clark says. However, while he may well not have intended to go beyond severely restricting the recent decision of this court in In re Transvision, Inc., 217 F. (2d) 243 (C. A. 3), his opinion may perhaps be read as intending to over-rule it. I think it desirable, therefore, to say that I am not ready to go that far,

although, had I been sitting in the panel which decided that case, I would have dissented. I would say here merely that I think the rationale of the Transvision decision should be limited to a case where the facts are in most respects similar, i. e., a case where (a) but a relatively small proportion of the securities is publicly held by a small number of investors, (b) none of the securities was listed on any exchange, (c) the assets do not exceed approximately $1,000,000, and (d) there are merely the faintest suspicions raising questions about the conduct of the management.

GALSTON, District Judge (dissenting)

I do not believe that Securities and Exchange Commission v. United States Realty & Improvement Co., 310 U. S. 434, compels an affirmance of the order below. Rather the circumstances presented in the present proceeding are essentially, in principle, the same as are set forth in In re Transvision, Inc., 217 Fed. 2d 243. Judge Medina, in the Transvision opinion, weighed both Securities Commission v. United States Realty Co., supra, and Mecca Temple, etc. v. Darrock, 142 Fed. 2d 869, but observed:

> "Nonetheless, the scope of the permissible inquiry into the propriety of proceeding under either chapter is not susceptible of ready definition solely in terms of the existence or non-existence of public stockholders."

Clearly herein there are presented but two classes of interests: (1) that of the stockholders; (2) that of unsecured creditors. It cannot be too strongly emphasized that neither the company itself nor its unsecured creditors seek a re-organization. A single stockholder and the Securities and Exchange Commission nevertheless intervene to thwart the plan of arrangement submitted by the corporation to its unsecured creditors which would enable those creditors to receive a full 100% payment of their claims.

What is to be effected by a plan of re-organization? What is there to re-organize?

An anomolous situation arises because if the debtor had moved in the first instance under Chapter 10, it is very doubtful whether in its petition it could have met the requirements of Section 530, Title 11 of Chapter 10. In that event it would seem that the provisions of Section 547 of Title 11, Chapter 10, would apply. That section provides that when a petition filed under Chapter 10 discloses that adequate relief could be obtained by the debtor under Chapter 11, an amendment to comply with the requirements of Chapter 11 could be made. See John Hancock Mut. Life Ins. Co. v. Casey, 141 Fed. 2d 104.

Acceptance of the plan of arrangement is on its face all that the company needs to carry on its affairs. The wage-earners who fall among the unsecured creditors, and who are eager to have prompt payment, certainly will suffer delay if proceedings are had under Chapter 10.

In the motion for leave to intervene made by the Securities and Exchange Commission it is alleged that "if the proposed arrangement is confirmed and the proceedings are not dismissed, the interests of investors in this proceeding will be improperly affected." But there is nothing in the record before this court which sustains that allegation.

The debtor has no funded debts by way of debentures or certificates of indebtedness of any kind—bonds, mortgages, notes or obligations of like character, sold, distributed or in the hands of the general public. So much appears in the affidavit of the president of the debtor. As I have intimated, the proposed plan of arrangement does not seek to modify in any form whatsoever the capital stock of the debtor.

The order under review, if the debtor desires to have the sanction of the Bankruptcy Act, leaves no alternative but to endeavor to comply with the requirements of Chapter 10. Failing that, it is faced with the necessity of endeavoring to settle with its creditors out of court. In

doing so if runs the hazard of committing an act of bankruptcy which might enable some creditors to file a petition in ordinary bankruptcy. So liquidation of the debtor would ensue. Chapter 10, as I have stated, is essentially designed to enable a debtor to work out a plan of reorganization. Historically its immediate predecessor was Chapter 77B of the Bankruptcy Act, and that in turn followed the old equity receivership, the outstanding characteristic of which was to seek a plan of reorganization of vested and conflicting interests.

It would seem to be sound common sense to leave the management of the business to the judgment of its officers and directors. There is not the slightest suggestion of the violation of any state law. Indeed if stockholders should determine that there has been bad management or misjudgment or fraud, ample relief is possible under the corporation laws of the State of New York, the domicile of the debtor.

For the foregoing reasons I feel impelled to dissent.

Judgment of Court of Appeals

United States Court of Appeals for the Second Circuit.

At a Stated Term of the United States Court of Appeals in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 14th day of April, one thousand nine hundred and fifty-five.

Present: Hon. Charles E. Clark, Chief Judge
Hon. Jerome N. Frank, Circuit Judge
Hon. Clarence G. Galston, District Judge

In the Matter of General Stores Corp., Debtor.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On consideration whereof it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed and action remanded in accordance with the opinion of this Court.

It is further ordered that the stay heretofore granted will remain in effect in accordance with the opinion of this Court until the District Court acts.

It is further ordered that a mandate issue to the said District Court in accordance with this decree.

(S) A. DANIEL FUSARO,
Clerk.

Filed April 14, 1953.

Stay of Proceedings Granted by the Court of Appeals Originally Pending Appeal and Now Pending Proceedings for Certiorari

A motion having been made herein by counsel for debtor-appellant for a stay pending appeal,

Upon consideration thereof, it is

Ordered that the effect of the order appealed from be and it hereby is stayed until determination of the appeal and in the meantime all parties to this proceeding are stayed from taking any steps to effectuate a plan of arrangement, including without limitation, its promulgation, filing, the soliciting of acceptances and its confirmation.

(S) A. DAVID FUSARO,
Clerk.

Filed April [illegible], 1953.

Stipulation and Order Staying Mandate

IT IS HEREBY STIPULATED, AGREED AND CONSENTED TO by and between the undersigned, the interested parties in the above entitled matter, that the issuance of the mandate of the Court of Appeals for the Second Circuit on its decision in the above entitled matter, made and entered on the 14th day of April, 1955, affirming the order of District Judge Edward J. Dimock dated February 4, 1955 and entered March 7, 1955, be stayed for thirty (30) days from the date of the entry of an order on this stipulation, pending the Debtor's application for certiorari to the Supreme Court of the United States from the aforesaid decision, and the said stay shall expire at the end of said thirty (30) days and the mandate issued forthwith at that time, unless within said thirty (30) days there is filed with the Clerk of the Court of Appeals for the Second Circuit, the certificate of the Clerk of the Supreme Court of the United States that the certiorari petition, record and briefs have been filed; whereupon, the said stay shall continue until the final disposition of the case by the Supreme Court of the United States; and in the meantime all parties to this proceeding are stayed from taking any steps to effectuate a plan of arrangement, including without limitation, its promulgation, filing, the soliciting of acceptances and its confirmation.

IT IS FURTHER STIPULATED AND AGREED that an order may be entered on this stipulation without further notice.

Dated: New York, New York, May 24, 1955.

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Attorneys for Debtor.

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Securities & Exchange Commission.

BLUMBERG, SINGER, HEPPEN & BLUMENTHAL,
Attorneys for Creditors of
General Stores Corporation.

WEINSHENKER & KENNER,
Attorneys for Wage Claimants.

So ordered
May 25, 1955.

(s) HAROLD R. MEDINA,
U. S. C. J.

Statutes

Pertinent provisions of the Bankruptcy Act of 1898, as amended, Section 12(d) (U. S. C. Sec. 30(d); 30 Stat. 549) before its provisions were incorporated in Chapter XI of the Bankruptcy Act of 1934, as amended, provided as follows:

> SEC. 12. Compositions; when confirmed. . . .
>
> (d) The judge shall confirm a composition if satisfied that (1) it is for the best interests of the creditors; (2) the bankrupt has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to his discharge; and (3) the offer and its acceptance are in good faith and have not been made or procured except as herein provided, or by any means, promises, or acts herein forbidden.

Pertinent provisions of Chapter X (Corporate Reorganizations) of the Bankruptcy Act of 1938, as amended, (The Chandler Act) (11 U. S. C. 501 et seq.; 52 Stat. 883):

Section 107 of the Bankruptcy Act (11 U. S. C. 507; 52 Stat. 884) provides:

> SEC. 107. Creditors affected by plan; determination:
>
> Creditors or stockholders or any class thereof, shall be deemed to be "affected" by a plan only if their or its interest shall be materially and adversely affected thereby. In the event of controversy the Court shall, after hearing upon notice, summarily determine whether any creditor or stockholder or class is so affected.

Section 130(7) of the Bankruptcy Act (11 U. S. C. 530(7); 52 Stat. 886) provides:

> SEC. 130. Contents:
>
> Every petition shall state . . . .
>
> (7) the specific facts showing the need for relief under this chapter and why adequate relief cannot be obtained under Chapter XI of this Act; . . .

Section 14 of the Bankruptcy Act (11 U. S. C. 541; 52 Stat. 887) provides:

> SEC. 541. Petition of debtor:
>
> Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied.

Section 146(2) of the Bankruptcy Act (11 U. S. C. 546(2); 52 Stat. 887) provides:

> SEC. 146. Good faith of petition:
>
> Without limiting the generality of the meaning of the term "good faith", a petition shall be deemed not to be filed in good faith if—
>
> (2) Adequate relief would be obtainable by a debtor's petition under the provisions of Chapter XI of this Act; . . .

Section 147 of the Bankruptcy Act (11 U. S. C. 547; 52 Stat. 888) provides:

> SEC. 147. Amendment of petition to comply with provisions governing arrangements:
>
> A petition filed under this chapter improperly because adequate relief can be obtained by the debtor under Chapter XI of this Act may, upon the application of the debtor, be amended to comply with the requirements of Chapter XI for the filing of a debtor's petition, and shall thereafter for the purposes of Chapter XI be deemed to have been originally filed thereunder.

Section 221(2) of the Bankruptcy Act (11 U. S. C. 621; 52 Stat. 897) provides:

> SEC. 221. Confirmation by Court:
>
> The judge shall confirm a plan if satisfied that—
>
> . . .
>
> (2) the plan is fair and equitable, and feasible;
>
> . . .

Pertinent provisions of Chapter XI (Arrangements) of the Bankruptcy Act (11 U. S. C. 701 et seq.; 52 Stat. 905, as amended).

Section 306(1) and (3) of the Bankruptcy Act (11 U. S. C. 706; 52 Stat. 906) provides:

> (1) "Arrangement" shall mean any plan of a debtor for the settlement, satisfaction or extension of the time of payment of his unsecured debts, upon any terms; * * *
>
> (3) "Debtor" shall mean a person who could become a bankrupt under Section 4 of this Act and who files a petition under this chapter; * * *

Section 308 of the Bankruptcy Act (11 U. S. C. 708; 52 Stat. 906) provides:

> SEC. 308. Creditors affected by arrangement; determination:
>
> A creditor shall be deemed to be "affected" by an arrangement only if his interest shall be materially and adversely affected thereby. In the event of controversy, the court shall after hearing upon notice summarily determine whether any creditor is so affected.

Section 322 of the Bankruptcy Act (11 U. S. C. 722; 52 Stat. 907) provides:

> SEC. 322. Original petition:
>
> If no bankruptcy proceeding is pending, a debtor may file an original petition under this chapter with the court which would have jurisdiction of a petition for his adjudication.

Section 328, as added to the Bankruptcy Act in 1952 (11 U. S. C. 728; 66 Stat. 432) provides:

> SEC. 328. Dismissal, proceedings; amended petition:
>
> The judge may, upon application of the Securities and Exchange Commission or any party in interest,

and upon such notice to the debtor, to the Securities and Exchange Commission, and to such other persons as the judge may direct, if he finds that the proceedings should have been brought under Chapter X of this Act, enter an order dismissing the proceedings under this chapter, unless, within such time as the judge shall fix, the petition be amended to comply with the requirement of Chapter X of this Act for the filing of a debtor's petition or a creditors' petition under such chapter, be filed. Upon the filing of such amended petition, or of such creditors' petition, and the payment of such additional fees as may be required to comply with Section 132 of this Act, such amended petition or creditors' petition shall thereafter, for all purposes of chapter X of this Act, be deemed to have been originally filed under such chapter.

Section 366 as amended in 1952 (11 U. S. C. 766; 66 Stat. 43) provides in pertinent part:

SEC. 366. Requisites for confirmation:

The court shall confirm an arrangement if satisfied that—

* * *

(2) it is for the best interests of the creditors and is feasible;

* * *

Confirmation of an arrangement shall not be refused solely because the interest of a debtor, or if the debtor is a corporation, the interests of its stockholders or members will be preserved under the arrangement.

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SUPREME COURT U.S.

No. 170

IN THE

Supreme Court of the United States

OCTOBER TERM 1955

GENERAL STORES CORPORATION, PETITIONER

vs.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS' COMMITTEE and WAGE CLAIMANTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER, GENERAL STORES CORPORATION

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 170

GENERAL STORES CORPORATION, PETITIONER

vs.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS' COMMITTEE and WAGE CLAIMANTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITIONER'S BRIEF

General Stores Corporation seeks reversal by this Court of the Judgment of the Court of Appeals for the Second Circuit, which affirmed by a divided court (2 to 1, with three separate opinions), the judgment of the United States District Court for the Southern District of New York in Proceedings for an Arrangement under Chapter XI of the Bankruptcy Act. Although the debtor seeks under that Chapter to compose its general unsecured trade and commercial debts, none of which is evidenced by any publicly held security, a single stockholder of the debtor and the Securities and Exchange Commission have nevertheless thwarted the proceeding by obtaining a judgment

dismissing the Arrangement proceedings under Chapter XI unless the petition is amended to comply with the provisions for Reorganization under Chapter X of the Bankruptcy Act.

Opinions Below

The opinions of the Court of Appeals are reported at 222 F. 2d 234. The opinion of the District Court is reported at 129 F. Supp. 801.

Jurisdiction

Petition for Certiorari was filed June 22, 1955. Certiorari to the Court of Appeals of the Second Circuit was granted by this Court on October 10, 1955, by authority of 28 U. S. C. 1254(1). See also Section 24(c) of the Bankruptcy Act, 11 U. S. C. 47(c).

Constitutional Provisions and Statutes Involved

All of the pertinent provisions of the United States Constitution, *i.e.*, Article I, Section 1 and Section 8, Clause 4; and of the Bankruptcy Act of 1898, Section 12; the Bankruptcy Act of 1938 (the Chandler Act) and the amendments of 1952, are set forth in the Appendix, *infra*, pages 43-51, *et seq.*

Questions Presented

1. Whether a corporate debtor can be denied the right to proceed under Chapter XI where it seeks merely an arrangement or composition of its general unsecured trade

and commercial debts not evidenced by any publicly held securities and where in no sense does it seek a corporate reorganization or any change whatsoever in its capital structure or its publicly held and listed common stock.

2. Whether a stockholder owning less than 2/10ths of one percent of the common stock of the debtor, in concert with the Securities and Exchange Commission, can compel transfer of such an arrangement proceeding initiated under Chapter XI to a reorganization proceeding under Chapter X in the total absence of even a suggestion of wrongs done stockholders or other persons. May the Court compel the debtor to forego the economies of Chapter XI for the elaborate, expensive and unnecessary proceedings under Chapter X merely on the request of the Securities and Exchange Commission for amplified investigatory authority, without evidence in the record of some wrong done or contemplated, or substantial question of the fairness or feasibility of the arrangement proposed pursuant to Chapter XI?

3. Whether Chapters X and XI are mutually exclusive and on what basis. Within this question is whether or not Congress intended to prevent debtors from employing Chapter X, when all that such debtors sought or required was an arrangement or composition of their unsecured trade and commercial debts; similarly, whether Congress intended, by removing the "fair and equitable" rule by the 1952 amendment to Chapter XI, that Chapter XI provided the only proper procedure for a composition with unsecured trade and commercial creditors while continuing the interest in the stockholders unchanged.

Statement of the Case

On October 18, 1954 General Stores Corporation, the debtor, filed a petition in the District Court for the Southern District of New York in accordance with the provisions of Sec. 322* of Chapter XI of the Bankruptcy Act for the reason that it was then unable to pay its debts as they matured. It proposed an arrangement of its general unsecured trade and commercial debts (R. 13a), none of which is evidenced by any publicly held security (R. 43a).

A summary of its assets and liabilities attached to the petition showed total assets in excess of total liabilities by $1,600,000. The proposed arrangement would have compulsory effect only on the general unsecured creditors. Under this plan they would receive 100% of their claims, 20% on confirmation of the plan and 20% annually thereafter.** Creditors entitled to statutory priority were to be paid in full (R. 14a).

The general unsecured creditors are: (a) those who are owed for merchandise, services, supplies, rents and salaries, shown in the debtor's Statement of Affairs (R. 41a) to aggregate $524,970.09; and (b) debtor's wholly owned subsidiary, the Stineway Drug Company, on notes aggregating $1,310,000.00 (R. 42a).

The debtor has no funded debts by way of debentures, no certificates of indebtedness of any kind, no bonds, mort

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* 11 U. S. C. § 722; 52 Stat. 907.

** Arrangement plans may be (and they usually are) altered or modified at various stages of a proceeding up to the time of confirmation as authorized by Sec. 363 (11 U. S. C. 763; 52 Stat. 911) of the Bankruptcy Act.

gage certificates, notes or obligations of like character, sold, distributed or in the hands of the general public (R. 42a). No secured obligation and no securities of any kind are affected by or intended to be modified in any manner or form by the arrangement (R. 43a).

The arrangement does not affect or seek to modify in any manner or form the capital stock of the debtor corporation. The authorized capital stock consists of 3,000,000 shares of common stock of the par value of $1.00 each and all of one class, of which there were issued and outstanding at the time of the petition 2,053,922 shares (R. 43a).

At present the debtor has two principal corporate assets. The first is the cash received from the liquidation of the Schulte Tobacco Stores, all of which stores the debtor has discontinued during the pendency of these proceedings; debtor has liquidated its inventories and practically all of its tangible assets.

The second asset is the debtor's equity in the capital stock of the Stineway Drug Company and the Ford Hopkins Company, both wholly owned by the debtor. As a going concern, the debtor also has a valuable asset in a carry forward operating tax loss (R. 66a-67a).

The Intervention to Dismiss Proceedings

On November 9, 1954, upon the petition of Max Shlensky, an alleged owner of 3,000 shares (less than 2/10ths of one percent of the common stock of the debtor), the District Court issued an order that the debtor and the Securities and Exchange Commission show cause why the proceedings for an arrangement under Chapter XI should not be

dismissed unless within a time fixed by the Court the petition be amended to comply with the requirements of Chapter X for the filing of a petition for reorganization under said Chapter (R. 17a). The Securities and Exchange Commission cross-moved for leave to intervene and for the same relief requested by Max Shlensky (R. 23a-28a).

On these motions the Court was asked to consider facts which the debtor submits are irrelevant and immaterial to its right to proceed under Chapter XI. For example:

(a) The outstanding stock is held by some 7,000 stockholders, is traded on the American Stock Exchange, and is in part registered with the Securities and Exchange Commission (R. 30a).

(b) The Corporation, organized in 1915 and formerly known as D. A. Schulte, Inc., was in a Section 77-B reorganization proceeding from 1938 to the consummation of a plan on April 30, 1940. During the war years it enjoyed a profitable operation but in the post-war period its volume began to fall, its profit became narrower, attempts at modernization of the Schulte type chain of stores failed, and the debtor embarked upon a program of discontinuing the operation of its Schulte type stores and purchased the outstanding capital stock of Stineway Drug Company and the Ford Hopkins Company, which owned chains of retail stores in Chicago and mid-western states and supplied other stores (R. 31a-33a).

(c) In November, 1952, the Corporation registered 741,647 shares of its common stock with the Securities and Exchange Commission and its original Registration Statement, dated November 12, 1952, had been periodically re-

vised, the last revision being dated July 21, 1954 (R. 31a). Under date of September 20, 1953 the stockholders were notified of the acquisition of the Stuyeway Drug Company and the reasons therefor (R. 70a-72a). In connection with the annual meeting of stockholders held February 10, 1954 the Corporation solicited proxies and sent out a proxy statement, as required by the rules of the Securities and Exchange Commission, which notified the stockholders of the Corporation's intention to purchase substantially all of the outstanding capital stock of Ford Hopkins Company (R. 67a and 73a-79a). Stockholders endorsed the program by 1,453,822 to 37,434 (R. 83a). The consummation of the Ford Hopkins purchase by the Corporation was reported to its stockholders by letter of June 30, 1954 (R. 79a-85a), and as pointed out, the Corporation's Registration Statement with the Securities and Exchange Commission was then amended as of July 21, 1954 (R. 31a).

The matter was heard by the Court, Dimock, D. J., and an opinion rendered on January 24, 1955 (R. 6a-12a). Motion for reargument was denied (R. 12a), and an order was entered on March 7, 1955 granting the Securities and Exchange Commission leave to intervene and dismissing the proceedings for an arrangement under Chapter XI unless on or before March 15, 1955 the debtor filed an amended petition, or before such date a creditors' petition be filed under Chapter X for reorganization (R. 3a-5a). This is the judgment which has been affirmed by the Court of Appeals except for the appellate court's direction to the District Court to set a new date within which the debtor or its creditors may file an amended petition under Chapter X if they so choose (R. pp. 5a and 9a).

Summary of Argument

The right which Congress has granted a corporate debtor, to seek confirmation of a plan for the settlement, satisfaction or extension of the time of payment of its unsecured debts upon any terms, through a proceeding under Chapter XI of the Bankruptcy Act cannot be denied by the court because the debtor is a "large" corporation and its stock publicly held. So long as the plan affects merely unsecured debts, the court is required to look to the best interests of the creditors, and there is no jurisdiction to recognize as "affected"* any stockholder or any class thereof or to recognize the Securities and Exchange Commission in so far as it seeks to act on behalf of public stockholders.

The 1952 Amendment, by removing from a proceeding in Chapter XI (and not in Chapter X) the rule in the *Boyd* case** that prevented "any scaling down of the claims of creditors without some fair compensating advantage to them which is prior to the rights of stockholders"*** has removed any threat upon the rights of stockholders in any arrangement for the settlement, satisfaction or extension of the time of payment of the corporation's unsecured debts. It is common knowledge that stockholders "stand to gain by the forbearance of the unsecured trade and commercial creditors."****

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* See Sec. 308 of the Bankruptcy Act and cf. Sec. 107.

** *Northern Pac. Ry. v. Boyd*, 228 U. S. 482 (1913). See also *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106 (1940).

*** *SEC v. U. S. Realty & Improvement Co.*, 310 U. S. 434 at 452.

**** *In re Transvision Inc.*, 119 F. Supp. 134 at 137; aff'd 217 F. 2d 243; cert. den. 348 U. S. 952.

The 1952 Amendment also made no distinction whatsoever in the type of debtor entitled to the benefits of Chapter XI, and one will search in vain for language which will justify dismissing a petition because the debtor is a "large" corporation and its stock publicly held.

However, in the present case the lower courts have followed this Court's decision in the *U. S. Realty* case* as justifying a presumption that "large" corporations with publicly held stock are *ipso facto* improperly in Chapter XI and are without adequate relief there. The reliance by the courts below on the *U. S. Realty* case has continued although it was decided prior to the 1952 Amendment and, in addition, involved a plan to alter and modify its publicly-held debt securities, which the court found on its face, under the statute then in force, could not be confirmed in Chapter XI.

Since that is the only decision by this Court relied upon by the courts below, in spite of very obvious distinctions, we are directing our argument here to the four general points considered by this Court in that case.

First, there can be no question but that the petitioner in this case and its proposed plan fully qualify by statute as a "debtor" and proposed "arrangement" respectively, entitled to consideration by the court in a proceeding under Chapter XI. The plan proposes only an extension of the corporation's trade and commercial debts, not evidenced by any publicly held securities. No alteration or modification of stockholders' rights is proposed. Unlike the situation presented by *U. S. Realty*, no court has said or can say that the plan proposed by General Stores could not qualify for confirmation in Chapter XI.

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* *SEC v. U. S. Realty & Improvement Co.*, 310 U. S. 434 (1940); rev'g 108 F. 2d 794.

Second, in consideration of such a plan, the court is without jurisdiction under the statute at the behest of a stockholder or on motion of the Securities and Exchange Commission, or on its own motion, to dismiss the petition because the debtor is a "large" corporation with public stockholders. Similarly, the court cannot dismiss the petition because it believes that procedures under Chapter X would be more adequate for the court's determination as to what would be in the best interests of the creditors. A transfer to Chapter X deprives debtor and its stockholders of the right to settle with creditors without a compensatory advantage to creditors as a priority over the rights of stockholders.* In addition, wage claim priorities may be lost.

Third, there is no showing of any irreparable damage that might follow unless these proceedings were transferred to Chapter X. Although without jurisdiction, the courts below have nevertheless allegedly exercised discretion to elect between Chapters X and XI in spite of the irreparable damage to the debtor and to the wage claimant creditors referred to. In addition, an official creditors' committee and an attorney representing wage claimants have appeared and argued against the necessity for such a transfer to Chapter X.

Fourth, the exercise of jurisdiction and discretion by the court to deny this debtor the right to proceed in Chapter XI is in violation of the Constitution of the United

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* Sec. 221 (2) under Chapter X contains the requirement under that Chapter that the plan be "fair and equitable" and therefore in compliance with the rule in the *Boyd* case, *supra*, page 8 herein.

States, which gave to Congress all legislative power and particularly the power to establish uniform laws on the subject of bankruptcies throughout the United States. At the time Congress enacted Chapter XI, it was fully familiar with the theory and argument that Chapter XI should be denied to "large" corporations with public stockholders. Congress refused to enact that theory into law, and the courts may not substitute their judgment in this regard for that of Congress.*

POINT I

The Bankruptcy Act has granted to the Court, by Chapter XI, full power to afford adequate relief to the debtor in this case, and therefore, by express provision of the Act, proceeding by Chapter X would be improper.

The essential characteristic of the debtor's petition in this case, as distinguished from the petition in the *U. S. Realty* case,** is the proposed plan. Of the plan in the *U. S. Realty* case this Court said:

> "The case stated most favorably to respondent (U. S. Realty) is that it has proposed an arrangement which appears on its face not to be 'fair and equitable' and hence not to be entitled to confirmation under Chapter XI." (310 U. S. at 456.)

In that case debtor's plan proposed that its guarantee of first mortgage certificates in the aggregate sum of $3,710,500 in the hands of some 900 holders was to be modi-

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* See the full dissenting opinion of Mr. Justice Roberts in the *U. S. Realty* case, *supra*, 310 U. S. at 461, *et seq.*

** *Supra*, page 9 herein

fied by an extension of the maturity of the certificates, a reduction of interest, and the elimination of any guarantee of sinking fund payments. Applying the "fair and equitable" rule of the *Boyd* case*, the debtor's plan was not entitled to confirmation because, while scaling down the claims of these creditors, it did not provide "some fair compensating advantage to them" as a priority to the rights of stockholders.

As thus stated and under the statute then in force (Section 366(3)) the facts in the *U. S. Realty* case compel the conclusion that adequate relief would not have been obtainable by the debtor's petition in that case under the then provisions of Chapter XI, and that promulgation of any other plan would have had to be effected under Chapter X.

The *Mecca Temple* case**, also relied on below***, followed directly on the facts and reasoning of the *U. S. Realty* case, and because the debtor there was not even a stock corporation but rather, a membership corporation, the case contributes nothing to an understanding of the questions in this case. The arrangement proposed by the Mecca Temple directly affected over 1,800 bondholders scattered throughout the country entitled to approximately $1,200,000 in principal and interest, by proposing to pay each bondholder 10c on the dollar over 10 years, without

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* *Supra*, page 8 herein.

** *Mecca Temple v. Darrock*, 142 F. 2d 869 (1944); cert. den. 323 U. S. 784.

*** Judge Clark, below, suggested that the panel which heard the *Transcision* case, *supra* page 8 herein, "rather slighted" the criteria set out in the *Mecca Temple* case. See 232 F. 2d at 236.

recognition of long overdue interest, which the Court of Appeals said was "palpably unjust" on the facts in that case. Again, the court also found that, measured by the *Boyd* rule, *supra*, the arrangement could not be "fair and equitable."

Since the *U. S. Realty* and *Mecca Temple* cases, Congress has deleted the requirement that a plan be "fair and equitable" and has been explicit that:

> "Confirmation of an arrangement shall not be refused solely because the interest of a debtor, or if the debtor is a corporation, the interest of its stockholders or members, will be preserved under the arrangement." (Present Section 366.)

On this amendment the House Report* stated:

> "Chapter XI has replaced the old composition procedure under former Section 12 of the Bankruptcy Act, where the fair and equitable rule did not apply. Nor is it practicable or realistic to apply the rule in a proceeding under Chapter XI, XII or XIII.
>
> "The proposed amendment is designed to remove the fair and equitable provision and by the paragraph (above quoted) added to each of the amended sections it is made clear that the rule of the Boyd and Los Angeles cases shall not be operative under those three chapters."

Absent the "fair and equitable" rule, the basic requirement as to the practical effect of an arrangement in Chapter XI is stated under Section 366 as amended in 1952, namely, that the court be satisfied that—

> "(2) it is for the best interests of the creditors and is feasible . . ."

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*House Report No. 2320, 82d Cong., 2d Sess., page 21.

There has been no suggestion in any of the opinions below that the court is without power under the present provisions of the Bankruptcy Act to confirm the arrangement proposed by General Stores Corporation. Its plan proposes to affect only its unsecured trade and commercial debts not evidenced by any publicly held security.

In two essential particulars, therefore, the relief requested by debtor's petition in the present case differs from the relief requested by *U. S. Realty:*

(a) General Stores wants to alter or modify only the terms of its trade and commercial debts not evidenced by any publicly held security, whereas U. S. Realty wanted to alter and modify only the terms of its guarantee contained in a widely and publicly held security;

(b) General Stores seeks to preserve the interests of its stockholders, which does not prevent confirmation of its plan under present Section 366. The U. S. Realty plan, on the other hand, proposed to scale down the claims of one class of its creditors without some fair compensating advantage to them by altering or modifying the rights of stockholders, and thus could not possibly obtain confirmation under Section 366(3) as then in force because on its face the plan was not "fair and equitable".

In short, adequate relief can, by the terms of Chapter XI as amended by Congress in 1952, be obtained by General Stores on its petition, whereas on the face of the U. S. Realty petition, adequate relief was not obtainable in Chapter XI as it was then in force.

Since the relief General Stores seeks can be obtained by its petition under the provisions of Chapter XI, the court would have been compelled by the provisions of Sections 141 and 146(2) of the Bankruptcy Act to have dismissed its

petition if brought under Chapter X; or in accordance with Section 147 have permitted amendment to comply with the requirements of Chapter XI.

The foregoing analysis of one of the most important questions presented on this appeal follows the argument used by this Court in its opinion in the *U. S. Realty* case, when it found jurisdiction to dismiss the proceeding in Chapter XI on the ground that, since the plan could not be confirmed, the proceeding was improperly brought under Chapter XI (a finding of jurisdiction thereafter codified* in 1952 by the addition of the new Section 328 in Chapter XI of the Bankruptcy Act).

This Court was also convinced of its power with respect to U. S. Realty because it was sure that

> ". . . if respondent had proceeded under Chapter X the judge would have been compelled upon inquiry to

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* As explained by the House Report No. 2320, of the 82d Congress, 2d Session, page 19: "Under Section 147 of Chapter X, a petition improperly filed thereunder, because adequate relief can be obtained by the debtor under Chapter XI, may be transferred to Chapter XI and thereafter, for the purposes of Chapter XI be deemed to have been originally filed thereunder. There is no corresponding provision in Chapter XI for a transfer of a Chapter XI proceeding, if improperly filed thereunder, to Chapter X. The proposed amendment supplies this lack. It codifies the law of the U. S. Realty & Improvement case, and adopts the procedure of Section 147 for transferring the proceeding to Chapter X." The codification of the law of the *U. S. Realty* case contained in the 1952 amendments is therefore limited to the holding that the court has the power to dismiss a petition in Chapter XI if improperly filed thereunder. In our opinion the House Report constitutes no acquiescence in the court's assumption of judicial discretion to dismiss petitions as "improperly brought" merely because debtor is a "large" corporation with public stockholders or because, in the eyes of the court, trade and commercial creditors might find some help in an SEC investigation and report.

> approve its petition on the ground that it complied with the requirements of Chapter X, and that adequate relief could not be obtained under Chapter XI." (310 U. S. at 455.)

This same reasoning, when applied to debtor's petition in this case, compels a contrary answer. Had General Stores moved first under Chapter X, it could not have made the essential allegations of a proper petition under Section 130(7), namely:

> "... specific facts showing the need for relief under this chapter and why adequate relief cannot be obtained under Chapter XI of this Act."

What is meant by "adequate relief" is clarified by the statute in sections following Section 141 which directs the judge to dismiss a petition in Chapter X if not satisfied that it "has been filed in good faith." Section 146 of the Act directs a finding that a petition shall be deemed not to be filed in good faith if—

> "(2) Adequate relief would be obtainable by a debtor's petition under the provisions of Chapter XI of this Act;"

Section 147 that follows provides for transfer of proceedings from Chapter X when the petition has been filed under Chapter X

> "... improperly because adequate relief can be obtained by the debtor under Chapter XI of this Act."

Whereas no relief in Chapter XI could be obtained by the debtor, U. S. Realty, or by its petition because of deficiencies on the face of its petition, no such disability exists in the case of the petition of General Stores. Using words

in their normal meaning, General Stores, as a "debtor" by Section 306(3) and 4(a) and as referred to in the above quoted Sections, is entitled to the benefits of Chapter XI of the Bankruptcy Act. Unless it fails to obtain the necessary consent of its creditors and thereafter confirmation of its plan by the court under Section 366 of the Act, all of the relief sought by General Stores can and will be obtained. Even if the statute did not so expressly refer to "adequate relief" as obtained by the *debtor* or by the *debtor's petition*, it would be a most unusual interpretation of the adequacy of the relief available in Chapter XI in this case to say that unsecured trade and commercial creditors not holders of publicly distributed securities as parties "affected" cannot obtain adequate relief merely because no provision is made in this chapter for a report by the SEC. The unsecured creditors are represented by their official Creditors' Committee and in addition, Wage Claimants are represented by their counsel, and both groups have urged the continuance of these proceedings in Chapter XI and are opposed to their transfer to Chapter X.

Since no relief is sought here against public security holders nor against stockholders, it is a strange construction of what is meant by "adequate relief" obtainable by the debtor or by a debtor's petition in this arrangement proceeding which would justify transfer of this proceeding to Chapter X over the objection of the debtor and its unsecured creditors.

On the contrary, the relief which the debtor here seeks, namely, an arrangement with its unsecured trade and commercial creditors, without altering or modifying the rights of its stockholders, cannot be obtained by the debtor or a

debtor's petition in Chapter X, and is the peculiar remedy or relief obtainable in Chapter XI. Since Section 221(2) of Chapter X still retains the "fair and equitable" requirement of a Reorganization plan, the rule in the *Boyd* case* makes the relief requested by General Stores unobtainable in Chapter X. In this case, therefore, it is not a question of whether "adequate" relief can be obtained by the debtor's petition but rather, whether "the" relief sought by the debtor can be obtained anywhere else except under Chapter XI.**

POINT II

In proceedings in Chapter XI to confirm an arrangement not altering or modifying the rights of stockholders, the Court is without discretion to dismiss the proceedings because it believes that the interests of stockholders might be better protected in a proceeding under Chapter X.

Since the courts below rely exclusively on the language of this Court's opinion in the *U. S. Realty* case in justification for dismissing the petition of General Stores Corporation, the error below arises from a failure to recognize the essential distinction between the two cases.

Under the Bankruptcy Act in force at the time of the *U. S. Realty* case, this Court was convinced that under the "fair and equitable" rule no plan could be effected "without some re-arrangement of its (U. S. Realty's) capital

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* *Supra*, page 8 herein.

** See *John Hancock Mutual Life Ins. Co.* v. *Casey*, 141 F. 2d 104 at 107 (1940), cert. den. 323 U. S. 713.

structure"* to provide a fair compensation for the scaling down of the creditors' rights, or in the alternative, that some other plan would have to be proposed which would satisfy the "fair and equitable" rule as being in the best interests of the public mortgage certificate holders without altering or modifying the rights of the stockholders.

Under the first alternative, the Court was justified in desiring the assistance of SEC when re-arranging capital stock, but its dismissal of the proceeding under Chapter XI was then mandatory because no such plan could be confirmed except in a proceeding under Chapter X.

The second alternative, not presented on the record** would have required, the court said,*** the expert aid and advice of the Securities and Exchange Commission, available only under Chapter X, in order to determine whether the supposed advantage to the class of creditors affected (the 900 mortgage certificate holders) was in their best interests. To the extent that this Court justified the exercise of discretion on the second alternative, it was obviously acting on behalf of a class of *creditors* specially committed to the guardianship of the Securities and Exchange Commission. Certainly, on this basis the court's holding constituted no precedent for dismissing the petition of General Stores in this case in the purported interest of its *stockholders*, particularly since their rights are neither proposed, nor required, to be altered or modified in this case.

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* 310 U. S. at 456.

** at page 453.

*** at page 454.

Limit of Interest of Stockholders and SEC as Recognized by Congress in Proceedings under the Bankruptcy Act

Obviously, the intervention of the Securities and Exchange Commission can be justified by the court on behalf of stockholders only where the stock interest is held by the investing public and is to be altered or modified by the proposed plan. It is important to note, however, the very limited recognition accorded by Congress to stockholders and to the Securities and Exchange Commission in the interrelated provisions governing proceedings under the Bankruptcy Act. The Securities and Exchange Commission and stockholders have been granted a status by Congress only in Chapter X and in that isolated instance in Chapter XI when proceedings under that chapter are brought improperly because the relief requested by the debtor cannot be obtained under Chapter XI.

The limited scope accorded SEC and stockholders in the Bankruptcy Act by Congress is demonstrated in that situation when management petitions for the debtor, or a creditors' petition is filed, for an adjudication in bankruptcy (under Section 59). Such proceedings threaten the entire interest of stockholders, whether or not they are members of the investing public, and in most cases also seriously prejudice the public investors in debt securities. Notwithstanding such destruction of values, the Securities and Exchange Commission has no status to intervene on behalf of such public investors, although, in an involuntary bankruptcy proceeding the debtor may petition for an arrangement under Chapter XI (Section 321) or for a reorganization under Chapter X (Section 127), and in a voluntary bankruptcy proceeding the creditors may petition for a reorganization under Chapter X (Section 127).

It is not surprising, therefore, that Congress has similarly made no provision for the protection of stockholders as persons affected in an arrangement proceeding under Chapter XI. In simple bankruptcy, Congress assumed that the stockholders have lost their interest. In an arrangement proceeding for a composition of the unsecured debts, Congress correctly assumed that the stockholders were not proper parties because they were not "affected". (Section 308).

Suppose the petition of the single stockholder in this case, owning less than 2/10ths of 1 per cent of the common stock, were somehow competent evidence of the lower court's conclusion* that stockholders in this case are "concerned" because their interests are not being protected in the present Chapter XI proceeding, or that stockholders "fear" the change from the Schulte type stores to regular drug stores may only postpone liquidation or reorganization. There would still be no more basis for the court's exercise of discretion to force these proceedings into Chapter X than there would be for a court in a simple bankruptcy proceeding to act at the behest of stockholders who would prefer to see the debtor avoid adjudication by transferring the proceeding into a reorganization.

Reverting to this Court's opinion in the *U. S. Realty* case, we can embrace the argument that the Securities and Exchange Commission was properly allowed to intervene in that case when some rearrangement of capital stock appeared inevitable for compliance with the "fair and equitable" rule of the *Boyd* case. Similarly we do not have to argue against this Court's opinion in the *U. S.*

* 222 F. 2d 234 at 236

Realty case as to the interest of the Securities and Exchange Commission in that case in the mortgage certificate holders. They were undoubtedly part of the public specially committed to the guardianship of the Commission and their rights and interests were being directly altered or modified by an arrangement which this Court said appeared on its face not to be "fair and equitable" (310 U. S. at 456).

On the other hand, after the 1952 Amendments had clearly distinguished between Chapters X and XI by the removal of the "fair and equitable" rule from the latter and not from the former, the *U. S. Realty* case is still being cited* as authority in the court to consider in a preliminary application the relative adequacy of the two chapters to a particular case, as if there were still alternative remedies and that all that a debtor can secure rightly or equitably in a Chapter XI proceeding is to be had in a Chapter X proceeding.** Although the debtor may not obtain the same relief under both chapters, the court below has assumed a discretionary power to "evaluate the sufficiency of the remedy for the apparent need . . . at the beginning of the proceedings."*** By what statutory authority can the court undertake such a preliminary investigation to determine which is the best remedy and which the more appropriate proceeding, whether to effect a composition with creditors not requiring an alteration or modification of stockholders' rights or to reorganize the corporation involving a rearrangement of its capital stock structure or, in the last analysis, to liquidate before the remaining assets are dissipated?

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* 222 F. 2d 234 at 236.

** The assumption by this Court in *U. S. Realty* at p. 456.

*** At p. 237.

However theoretically ideal such a preliminary exploration under the aegis of the court with the advice of the Securities and Exchange Commission might appear, such is not the policy of the Bankruptcy Act as written by Congress. Only the debtor or its creditors may move a proceeding out of straight bankruptcy in which proceeding the Securities and Exchange Commission has no part. Congress has encouraged all debtors who seek only a composition with their unsecured creditors to proceed in Chapter XI (making it improper for the court to entertain such a petition in Chapter X). The Securities and Exchange Commission and stockholders have been given only the most limited status in Chapter XI to be exercised only if debtor's petition is improperly in that chapter.

The Formality and Adequacy of Proceedings in Chapter XI in the Interests of Creditors

Much of the pressure on appellate courts to transfer proceedings to Chapter X is based upon the erroneous argument that Chapter XI is "informal", "summary" and under the "control of the debtor." Of course that is not so. The error of such argument is most apparent in a case like the present involving only trade and commercial debts, none of which is evidenced by publicly held securities.

A proceeding in Chapter XI is not under the control of the debtor, but rather, under the control of the court acting particularly in the interests of the unsecured creditors represented by their creditors' committee. The debtor must file with the court in the first instance (Section 324) a statement of executory contracts, schedules of its property, lists of all its creditors in form like those filed by a bankrupt (Section 7a(8)) and a statement of its affairs. Under the

District Court rules of the Southern and Eastern Districts of New York (Rule XI-2) the debtor must also file immediately with its petition a list of its ten largest creditors and it is the court's duty, upon the filing of a petition and on notice to these ten creditors (Rule XI-4(a)) to promptly hold a hearing, as provided by Section 326, to determine the question as to whether the debtor should file a bond or other undertaking to indemnify the estate against subsequent loss thereto or diminution thereof, and to call a meeting of all creditors within 30 days (Sec. 334; Rule XI-4(b))

As a practical matter, the initiative in the proceeding which may have been with the debtor upon the filing of the petition, now shifts entirely to the court with the advice of the ten largest creditors, and it is they who decide whether indemnity is required and in what amount. As a practical matter, also, the court may then impose conditions upon the action of the debtor in lieu of or in addition to indemnity, as may be suggested by the ten largest creditors, such as the countersigning of checks, limitations upon purchase and sale of goods and incurring expenses without the consent of the creditors' designee, etc.

Certainly by this time, if not long before, a creditors' committee has come into being and this committee, by the 1952 Amendments to the Bankruptcy Act, has an official status in the proceeding even before the first meeting of all general creditors (Section 338). Of the function of a creditors' committee the House Report on the 1952 Amendment states:

> "It has been held that the 'committee of creditors' means the official committee appointed under Section 338; that the only expenses allowable are those incurred by such committee, its attorneys or agents after

the appointment, and are further restricted to the expenses incurred by them in passing judgment upon the plan and making such judgment known to the debtor and creditors; and that the expenses incurred by any other committee, its attorneys or agents are not allowable. Lane v. Haytian Corp. of America, 117 F. 2d 216 (1941).

"The provisions have not worked out satisfactorily. The appointment of the official committee at the first meeting of creditors, at which are also received and determined the acceptances by creditors of the arrangement (Section 336(4)) gives such official committee little opportunity, if any, to function for the benefit of creditors in passing judgment on the arrangement unless the proceeding, which has been fashioned to be streamlined, is delayed and slowed up in order to enable the committee to make its investigations and examinations, and to secure any desired improvement or other modification in the terms of the offer for the benefit of creditors. Obviously, the provisions are badly timed in their coordination and are not realistic.

"Moreover, negotiations for a settlement between a debtor and his creditors are generally started before Chapter XI is resorted to, in the hope that an out-of-court arrangement can be effected. When this attempt fails, usually because of a recalcitrant minority, Chapter XI is resorted to in order to bind a non-accepting minority. But before the arrangement petition is filed, much, if not all, of the spade work may have been done, such as investigations, book examinations, solving of legal problems and negotiations which developed or will substantially contribute toward the development of the arrangement, and the unofficial committee, its attorneys and agents, usually continue to render services after the petition is filed and until the first meeting of creditors, at

which the official committee may be appointed." (House Report No. 2320, 82nd Cong., 2d Sess., pp. 19 and 20)

It is important to note, however, that in amending Chapter XI in 1952 to recognize and reimburse the unofficial creditors' committee and its agents, the necessary qualifications of such committee were retained. As the House Report stated:

"Such committee must have been selected by not less than a majority in amount of the unsecured creditors (exclusive of the disqualified creditors enumerated in Section 44) and in fixing allowances, only the services which contributed to a confirmed arrangement, or, carrying through the objections of Section 661a(3), to the refusal of the confirmation of an arrangement, or which were beneficial in the administration of the estate, are to be considered by the court. The first qualification avoids ramp committees and permits of only a single committee which must represent not less than the majority interest; the second qualification limits the type of services, and the proper costs and expenses incidental thereto, which the court may consider in fixing the amount of the allowance." (Ibid., p. 20)

Since, as a practical matter, the debtor cannot make any move without the consent of the court and the court, as a practical matter, will be persuaded by the advice of a creditors' committee as to what are reasonable restrictions upon the activities of a debtor, the debtor is

* The following are prohibited from acting as "creditors" in appointing a creditors' committee: debtor's stockholders, officers and members of its board of directors or other similar controlling bodies.

no longer in control of his business. As a practical matter also, a debtor who in good faith seeks a composition with his creditors in Chapter XI is no longer in control of that proceeding because he is found thereafter to negotiate with and observe the recommendations of the creditors' committee if he expects to obtain the requisite acceptances for his plan. In practical effect, the plan ceases to be the debtor's but, rather, a negotiated plan which has the recommendation and approval of the creditors' committee.

Under these circumstances also, the debtor is forced to provide the creditors' committee and its accountant and attorney with all of the necessary financial facts upon which the creditors' committee may act. For a non-cooperative debtor, Section 21a examinations are fully authorized in Chapter XI (Section 302) and as a practical matter, with this power the court usually directs a debtor to make available to a creditors' committee and its accountants and attorney whatever the creditors' committee deems necessary under the circumstances, including a complete investigation of the debtor's books, records, documents and affairs.

The recalcitrant debtor faces a denial by the court of confirmation of his plan if he refuses to obey any lawful order of, or to answer any material question approved by, the court (Section 366(3) and Section 14c(6)).

Throughout the Chapter XI proceeding the debtor is constantly faced with adjudication in bankruptcy or dismissal of proceedings if he fails to satisfy his creditors and the court that his plan is in the interests of the creditors.

Although it is true, in the Southern District of New York, that the court does not as a regular practice appoint receivers of a debtor in Chapter XI, we understand that the opposite is the practice in the district courts of a number of other states. In view, however, of the power of the court in a Chapter XI proceeding over the actions of the debtor, it may well be that a receiver is not required. In any case, there is no greater fallacy than to assume that a proceeding in Chapter XI is "informal", "summary" or that the debtor is "in control" of the proceeding.

The Inadequacies of Proceedings in Chapter X in the Interests of the Debtor and Its Stockholders

Pressure on the court to transfer proceedings in Chapter XI to proceedings in Chapter X is often based on another fallacious assumption:—that everything the parties interested in a Chapter XI proceeding could get in that proceeding can be obtained by a petition in Chapter X. This is far from the truth.

(a)

The most important distinction is that Chapter XI alone provides relief to the debtor and its stockholders by effecting a composition with unsecured creditors without at the same time necessarily requiring a compensatory advantage to such creditors as a priority over stockholders. This important advantage of Chapter XI over Chapter X arises from its origins as the successor of the composition Section 12 of the Bankruptcy Act of 1898 as confirmed by the 1952 Amendments to the Bankruptcy Act which corrected the holding by this Court in the *U. S. Realty* case.

(b)

There is another important advantage to Chapter XI which is not clearly appreciated by some of the appellate courts, namely, the loss in a proceeding under Chapter X of all of the experienced management of the debtor. It is not true that management is *ipso facto* in error because a corporation is in financial difficulties. There are many economic factors which may have caused the difficulties and which may not be laid to the door of management.

However, a Chapter X proceeding, when all that is needed is an extension or scaling down of unsecured debts, constitutes a confession that management has no feasible plan acceptable to its unsecured creditors and that its initiative and judgment ought to be taken over by the SEC and the court.

(c)

Finally there is the not inconsiderable burden of expense and dangers of delay which are the necessary characteristics of a proceeding in Chapter X and which are usually avoided by a proceeding in Chapter XI.

In *U. S. Realty*, this Court adverted (310 U. S. at 449) to the provisions in Chapter X that require in that proceeding the appointment of a disinterested trustee, Sections 156-158, and a thorough examination and study by the trustee of the debtor's financial problems and management, Section 167(3)(5). The trustee is required to report on the result of his study, to send the report to all security holders with notice to submit to him proposals for a plan of reorganization, Section 167(5)(6). He then formulates a plan or reports the reasons why a plan cannot be formulated, Section 169. If the Judge finds the plan presented

worthy of consideration, he must in all cases where the liabilities of the debtor exceed $3,000,000 (and he may in smaller cases) refer the plan to Securities and Exchange Commission for report. Section 172. The report of the Securities and Exchange Commission and the opinion of the Judge approving the plan must then be submitted to creditors, Section 175.

The expenses of such elaborate proceedings are considerable. The trustee, reorganization manager, creditors' committees, stockholders' committees and their respective counsel and agents must be reimbursed and compensated. The proceeding has been correctly labelled "detailed and cumbersome"*, and "elaborate investigatory and protective procedures."**

But merely because Chapter X requires such elaborate, detailed, cumbersome and expensive procedures does not mean that proceedings under Chapter XI in contrast are "informal" or "summary." Where the capital structure and secured debts must be rearranged and adjusted in addition to effecting a composition with unsecured creditors, a much more elaborate procedure must necessarily be used. There is no reason, however, why such an elaborate procedure must be followed when all that is required is a composition with unsecured creditors. To use the more cumbersome proceeding is a waste of money and time.

In short, Chapter XI, not Chapter X, provides adequately for the interests of the debtor and unsecured creditors, and so long as the plan seeks a composition with

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* 310 U.S. at 464.

** 217 F. 2d at 246.

unsecured creditors not public security holders, there is no basis in the statute for stating that adequate relief cannot be had in Chapter XI. No modification or alteration in the rights of stockholders is contemplated, and it is unrealistic to make a distinction between the debtor and its stockholders, since stockholders are bound to gain by the composition.

Since Congress has made available in Chapter XI relief to a financially embarrassed corporation which may not be obtained in Chapter X, it requires the very clearest language in the statute for the court to deprive a particular corporation of the benefits of Chapter XI. There is nothing in the policy of the Bankruptcy Act which requires a dismissal of the petition under the circumstances of this case.

POINT III

No basis was presented in this case for the exercise of the Court's discretion to withhold relief under Chapter XI, even if Congress had authorized the use of such discretion.

To the extent that the courts below in this case may be said to be applying their discretion on behalf of creditors, they have acted without recognition of the adequacy of Chapter XI to proceed in the best interests of creditors.* In any event, there is nothing alleged in this case as to any irreparable damage to creditors threatened by a continuance of these proceedings in Chapter XI.

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* See pages 23, *et seq.* herein.

It is equally true that no similar threat to stockholders by a continuance of these proceedings in Chapter XI is alleged. Judge Clark, below, assumed (on the intervention of one stockholder, owning less than 2/10ths of 1 per cent of the outstanding stock) that stockholders, as distinguished from the debtor, are "concerned" about their stock interest, and that they "fear" that the debtor's program may only postpone liquidation, and that they "wish some assurance" now, before the remaining assets are dissipated.* No allegations of "concern", "fear" or desire for "assurance" have ever been made on behalf of stockholders in this case.

As we have shown, there can be no threat to stockholders in a proper proceeding under Chapter XI, which seeks only a composition with the unsecured creditors without altering or modifying the rights of stockholders. In any case, the record in this proceeding is barren of any allegation of threatened damage to stockholders which may result from a continuance of these proceedings in Chapter XI.

Certainly, the fact that General Stores (under the name of D. A. Schulte, Inc.) went through a 77-B reorganization from 1938 to 1940, which was more than 14 years prior to the present proceedings, cannot be held to be either relevant or material. The fact that General Stores has, in the immediate past, lost money on the Schulte type tobacco store operation and has been discontinuing them and has purchased a drug store and restaurant chain to take their place, is no evidence of threatened damage to stockholders by continuance of the Chapter XI proceeding.

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* 222 F. 2d 234 at 236.

Neither the single stockholder, Max Sidensky, nor the Securities and Exchange Commission, has alleged that anything done by the debtor has been improper or even improvident. General Stores has been registered with the SEC since 1952, and all of the facts alleged in the intervenors' petitions come from the information filed by General Stores with the SEC and, in many cases, distributed as informative letters to all the stockholders. If the Securities and Exchange Commission felt that the action of management needed investigation to prevent irreparable damage to stockholders by a continuance of the Chapter XI proceeding, it has neither made that charge nor presented any facts from which that charge could be inferred.

For all that the court knows, an investigation by the Securities and Exchange Commission in a Chapter X proceeding would do no more than confirm the sound business judgment of debtor in getting out of the Schulte type stores and into the drug store and restaurant chain business, and that from economic causes beyond the control of management, debtor is financially embarrassed and needs only time from its unsecured creditors or a scaling down of its unsecured creditors' claims.

Resort to the expensive, cumbersome, elaborate and long drawn out procedures of Chapter X to reach eventually such a conclusion would be totally unnecessary. This would be true even if the relief of simple composition were available (which it is not) in a Chapter X proceeding.

Even if there were an equity interest of stockholders existent and properly pleaded, which we certainly deny, the court is bound to weigh the great disadvantages to the other parties interested by a dismissal of these proceed-

ings. We have already pointed out that the debtor and its stockholders cannot obtain the same relief in a proceeding under Chapter X and that the relief available in Chapter XI must surely be in the better interests of the stockholders than any "reorganization" under the provisions of Chapter X.*

We have also pointed out the important position of a creditors' committee in Chapter XI,** and we emphasize that the creditors in this case as represented by their Creditor's Committee believe it is in the interests of creditors that these proceedings continue in Chapter XI.

Finally, this Court has been made aware of the interests of wage claimants who feel that they will be very badly prejudiced by a dismissal of these proceedings.*** The filing of the petition under Chapter XI has created priorities for these wage claimants under Section 64a of the Bankruptcy Act for payment of wages not exceeding $600 each, earned by them within three months prior to the filing of the Chapter XI petition. The wage claimants point out that the priority of wage claimants recognized under Chapter XI and in straight bankruptcy do not apply in Chapter X (Sec. 102).

There is no basis, therefore, against the interests of general creditors and wage claimants, as well as against the interest of the debtor and its stockholders, considered realistically, for the court to assume equity jurisdiction to

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* *Supra*, pages 18 and 28 herein.

** *Supra*, page 24 herein.

*** Petition and Brief of Respondents, Wage Claimants, filed on application for Writ of Certiorari in this case.

deny relief to the petitioner in this case under Chapter XI. Mr. Justice Roberts, in his dissent in the *U. S. Realty* case, has denied that the court has the power to dismiss this type of proceeding on the basis of "equity", stating:

> "The legislature has specified who is entitled to the relief provided by the statute and in what circumstances. The court has no power to refuse that relief on the ground that some other relief would better serve the purpose. What is meant by the statement that a court of bankruptcy is a court of equity is that its function is to make an equitable distribution of the estate among the creditors, but the principle has not been applied in the sense that the court may, in its better judgment, refuse to award the relief which Congress has accorded the bankrupt." (310 U. S. at 468.)

This may be contrasted with the prevailing opinion of this Court in the same case, in which Mr. Justice Stone said:

> "We cannot assume that Congress has disregarded well settled principles of equity, the more so, when Congress itself has provided that the relief to be given shall be 'fair and equitable and feasible'." (310 U. S. at 468.)

It seems clear that when Congress in 1952 corrected Chapter XI and omitted the requirement that relief to be given shall be "fair and equitable and feasible" and instead, left to the court to determine whether it was "in the best interests of creditors", Congress at the same time withdrew from the court the discretionary power asserted in *U. S. Realty* to grant or withhold relief under Chapter XI on an equitable basis and in the interest of others than creditors.

Certainly the deletion of "fair and equitable" from the statute in 1952 was no codification of the law expressed by this court in *U. S. Realty* but rather a fundamental correction. From 1952 it is clear that in an arrangement proceeding requiring no relief from stockholders, the court lacks discretion in the interests of stockholders on general allegations of convenience of the Securities and Exchange Commission to dismiss the proceeding. A court has no discretion, in the interest of stockholders, to dismiss the proceeding merely to provide the Securities and Exchange Commission an investigatory status in addition to what it already possesses under the Securities and Exchange Act of 1933.

POINT IV

The denial of relief under Chapter XI in this case is in derogation of the supreme constitutional right in Congress to establish uniform laws on the subject of bankruptcy.

The largest question with which this Court dealt in the *U. S. Realty* case (although not directly presented in that case) is whether a court can deny the debtor the right to proceed in Chapter XI although the debtor and debtor's plan fully qualify under the Congressional statute. That is the question which is directly presented in the present case, and, we assume, influenced this Court to grant certiorari.

Of course, if Chapters X and XI are elective proceedings providing equally satisfactory relief to the debtor, the debtor could have no grievance. But Congress expressly made the Chapters mutually exclusive so far as the

adequacy of the relief to the debtor is concerned.* By the 1952 Amendment, Congress returned to Chapter XI the availability of relief as recognized in the former composition section of the Bankruptcy Act of 1898,** which relief to the debtor is totally unavailable in Chapter X, namely, the right to an arrangement extending, modifying or scaling down unsecured debts without a compensatory change in the rights and privileges of stockholders.***

What Congress has given, may the courts take away?

This Court does not need to be reminded that all legislative powers, and in particular, the power to establish uniform laws on the subject of bankruptcies throughout the United States, have been granted by the Constitution to Congress.**** Where statutory language is as plain and unambiguous as it is in Chapter XI, recourse should not be had to legislative history and other extraneous aids to construe the language in some other sense or to add to or to subtract from what is written.***** To find an unexpressed Congressional purpose to deny a right to proceed in Chapter XI which the language of that chapter rather clearly grants, goes beyond the construction of the Act as it is written, and amounts to an amendment of it.

There is nothing unclear in the statute as enacted by Congress with regard to the qualifications of a debtor entitled to petition and proceed in Chapter XI.

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* Sections 130(7), 141, 146(2) and 147.

** Section 12 of the Bankruptcy Act of 1898.

*** See, *supra*, pages 18 and 28 herein.

**** Constitution, Article I, Section 1 and Section 8, Clause 4.

***** Mr. Justice Roberts in the *U. S. Realty* case, 310 U. S. at 1056 and cases cited by him.

By Section 306(3), Congress has defined such a debtor as "a person who could become a bankrupt under Section 4" of the Act. Section 4 states:

> "a. Any person, except a municipal, railroad, insurance, or banking corporation or a building and loan association, shall be entitled to the benefits of this Act as a voluntary bankrupt."

The arrangement which such debtor may present to the court for confirmation is defined by Congress as "any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms" (Section 306(1)).

It was clearly recognized by this Court that there was nothing in the language of Chapter XI which compels a finding that a "large" corporation cannot become a debtor under Section 306(3) or that an arrangement with regard to a debtor's unsecured debts cannot be confirmed in Chapter XI where there are public stockholders. This Court expressly stated that

> ". . . we find in neither chapter any definition or classification which would enable us to say that a corporation is small or large, its security holders few or many, or that its securities are 'held by the public', so as to place the corporation exclusively within the jurisdiction of the court under one chapter rather than the other."* (310 U. S. at 447.)

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* The apparent conflict between Chapters X and XI, if the arguments of the SEC were to prevail, was noted before this Court's decision in the *U. S. Realty* case in 48 Yale Law Journal, p. 1334 at 1364, and after the decision of this Court, in 40 Columbia Law Review, 1245 at 1251. The omission of status of the SEC in straight bankruptcy and the failure of Congress to expressly amend the law in accordance with the contentions of SEC, seems to have escaped the commentators.

It is most significant that this Court was not content in the *U. S. Realty* case to base its decision on a construction of the statute "as if" it contained a statutory limitation upon those qualified to proceed under Chapter XI. As we have pointed out, this Court emphasized by the express terms of the statute that it was not the character of the debtor, but rather, the effect of the debtor's plan under the "fair and equitable" rule which disqualified U. S. Realty from proceeding in Chapter XI. How much simpler it would have been, had Congress in fact limited the availability of Chapter XI, for this Court to have held that "debtor" by definition in Chapter XI excludes, as Judge Frank, below, suggests, any corporation whose securities are substantially held by the public or listed on any Exchange, and whose assets exceed approximately $1,000,000.*

This Court, instead, held that it had a right to dismiss the petition in the *U. S. Realty* case upon the failure of the plan in that case to qualify for confirmation, and suggested that under the "fair and equitable" requirement of the statute, the hope of presenting any plan which might be confirmed under Chapter XI was at best but negligible. In the absence of a provision in Chapter XI corresponding to Sections 146(2) and 147 of Chapter X, this Court assumed power in the initial stages of the proceeding under Chapter XI to dismiss the petition rather than permit the proceeding to continue to the inevitable dismissal under Section 376 when the plan would fail of confirmation.

It was this power in the court to early dismiss a proceeding, if improperly filed, which was codified by Congress

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* 222 F. 2d at 237.

in 1952 in the new Section 328.* Nowhere in that new Section 328 is there any recognition of a new limitation upon the type of "debtor" entitled to the benefits of Chapter XI. Nor is there any recognition of a new discretionary power in the court to substitute its decision for that of the debtor on the question of whether the attempt should be made to settle with creditors without altering or modifying the stockholders' rights, rather than to lose this advantage by reorganizing in Chapter X.

What Mr. Justice Roberts said in his dissenting opinion in the *U. S. Realty* case is much more applicable to the facts and contentions in our case because the issue here is so much more clearly drawn. No class of the unsecured debts of General Stores Corporation is evidenced by publicly held securities, and the only persons falling within a class over whom the Securities and Exchange Commission can be said to have special guardianship are the stockholders, who must gain by a composition with creditors and may well lose in a reorganization. Judge Roberts, in the *U. S. Realty* case, said:

> "Where the words are as plain and unambiguous as they are in Chapter XI, recourse cannot be had to legislative history or other extraneous aids to construe them in some other sense, to add to, or to subtract from, what is written (citing precedents)." (310 U. S. at 462.)

Reviewing, however, the material before Congress at the time of the adoption of the Chandler Act, it seems clear that no narrow application of Chapter XI to small corporations which had not issued securities to the public was

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* House Report No. 2320, 82d Congress, 2d Session, page 19. See also note to page 15 herein.

ever intended. Mr. Justice Roberts points out that Congress consciously rejected such a limitation:

> ". . . that Chapters X and XI were not written in ignorance of the distinction between corporations having publicly owned securities and those which have not, is shown by the fact that a special committee's report called attention to this difference and suggested that corporations not having such securities outstanding be permitted to go under the arrangements chapter whereas the first named should be required to file under what is now Chapter X.* With this suggestion before it, Congress adopted a different criterion." (310 U. S. at 466.)

The inescapable conclusion from the problems raised in the courts on the application of this Court's decision in the *U. S. Realty* case demonstrates that the arguments presented by the Securities and Exchange Commission ought to be addressed to Congress and not to this Court. The failure of the Securities and Exchange Commission over the past seventeen years to obtain recognition of its position from the Congress demonstrates that the legislative policy which it suggests in this case does not exist. As between the claims of the Securities and Exchange Commission and those of corporate debtors, Congress has refused to deny the benefits of Chapter XI to corporations merely because they are large or their securities publicly held. Congress does not believe that the advantages of composition with unsecured creditors (which advantages will flow to stockholders whose rights will be unaltered) should be withheld from large corporations and their public stockholders.

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* Sen. Doc. 268, 74th Cong. 2d Sess., pages 9-15.

In the last analysis, the function of the Securities and Exchange Commission within the framework of each of the separate proceedings authorized by the Bankruptcy Act must be established by Congress, and it is from that body that the Commission must obtain its mandate. Certainly, in the absence of any equitable considerations presented by the Securities and Exchange Commission in this case, there is no need whatsoever for searching for any unexpressed policy of Congress at variance with the clear statutory language of Chapter XI as presently in force.

CONCLUSION

The decision of the Court of Appeals should be reversed with a mandate that the District Court deny the applications of the respondent Max Shlensky and the Securities and Exchange Commission so that this proceeding for an arrangement may continue.

Respectfully submitted,

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November 24, 1955.

APPENDIX

Constitution, Article I.

SEC. 1:

All legislative Powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives.

SEC. 8, Clause 4:

The Congress shall have Power To . . . establish . . . uniform Laws on the subject of Bankruptcies throughout the United States.

Statutes

Pertinent provisions of the Bankruptcy Act of 1898, as amended and of the Chandler Act of 1938 as amended follow:

Bankruptcy Act of 1898, as Amended: Section 12(d) (11 U. S. C. Sec. 30(d); 30 Stat. 549).

SEC. 12. Compositions; when confirmed. . . .

(d) The judge shall confirm a composition if satisfied that (1) it is for the best interests of the creditors; (2) the bankrupt has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to his discharge; and (3) the offer and its acceptance are in good faith and have not been made or procured except as herein provided, or by any means, promises, or acts herein forbidden.

The Chandler Act of 1938, as Amended (11 U. S. C. 1 et seq.; 52 Stat. 840).

A. From Chapters I to VII:

SEC. 4 (11 U. S. C. 22; 52 Stat. 845). Bankrupts: Who may become:

a. Any person, except a municipal, railroad, insurance, or banking corporation or a building and loan association, shall be entitled to the benefits of this Act as a voluntary bankrupt.

SEC. 7 (11 U. S. C. 25; 66 Stat. 422). Duties of bankrupts:

a. The bankrupt shall

(8) prepare, make oath to, and file in court within five days after adjudication, if an involuntary bankrupt, and with his petition, if a voluntary bankrupt, a schedule of his property, showing the amount and kind of property, the location thereof and its money value, in detail; and a list of all his creditors, including all persons asserting contingent, unliquidated, or disputed claims, showing their residences or places of business, if known, or if unknown that fact to be stated, the amount due to or claimed by each of them, the consideration thereof, the security held by them, if any, and what claims, if any, are contingent, unliquidated, or disputed; and a claim for such exemptions as he may be entitled to;

SEC. 14 (11 U. S. C. 32; 66 Stat. 422). Discharges, when granted:

c. The court shall grant the discharge unless satisfied that the bankrupt has

(6) in the course of a proceeding under this Act refused to obey any lawful order of, or to answer any material question approved by, the court;

Appendix.

SEC. 21 (11 U. S. C. 44; 66 Stat. 423). Examination of bankrupt:

a. The court may, upon application of any officer, bankrupt or creditor, by order require any designated persons, including the bankrupt and his or her spouse, to appear before the court or before the judge of any State court, to be examined concerning the acts, conduct, or property of a bankrupt:

SEC. 44 (11 U. S. C. 72; 54 Stat. 835). Trustees; creditors' committees; and attorneys:

a. The creditors of a bankrupt, exclusive of the bankrupt's relatives or, where the bankrupt is a corporation, exclusive of its stockholders or members, its officers, and the members of its board of directors or trustees or of other similar controlling bodies, shall, at the first meeting of creditors after the adjudication, or after a vacancy has occurred in the office of trustee, or after an estate has been reopened, appoint a trustee or three trustees of such estate . . .

b. Such creditors may, at their first meeting also appoint a committee of not less than three creditors, which committee may consult and advise with the trustee in connection with the administration of the estate, make recommendations to the trustee in the performance of his duties and submit to the court any question affecting the administration of the estate.

B. From Chapter X:

SEC. 107 (11 U. S. C. 507; 52 Stat. 884). Creditors affected by plan; determination:

Creditors or stockholders or any class thereof shall be deemed to be "affected" by a plan only if their or its interest shall be materially and adversely

affected thereby. In the event of controversy, the Court shall, after hearing upon notice, summarily determine whether any creditor or stockholder or class is so affected.

SEC. 127 (11 U. S. C. 527; 52 Stat. 885). Pending bankruptcy proceedings:

A petition may be filed in a pending bankruptcy proceeding either before or after the adjudication of a corporation.

SEC. 130(7) (11 U. S. C. 530(7); 52 Stat. 886). Contents:

Every petition shall state

(7) the specific facts showing the need for relief under this chapter and why adequate relief cannot be obtained under Chapter XI of this Act; . . .

SEC. 141 (11 U. S. C. 541; 52 Stat. 887). Petition of debtor:

Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied.

SEC. 146(2) (11 U. S. C. 546(2); 52 Stat. 887). Good faith of petition:

Without limiting the generality of the meaning of the term "good faith", a petition shall be deemed not to be filed in good faith if—

(2) Adequate relief would be obtainable by a debtor's petition under the provisions of Chapter XI of this Act; . . .

SEC. 147 (11 U. S. C. 547; 52 Stat. 888). Amendment of petition to comply with provisions governing arrangements:

A petition filed under this chapter improperly because adequate relief can be obtained by the debtor under Chapter XI of this Act may, upon the application of the debtor, be amended to comply with the requirements of Chapter XI for the filing of a debtor's petition, and shall thereafter for the purposes of Chapter XI be deemed to have been originally filed thereunder.

SEC. 221(2) (11 U. S. C. 621; 52 Stat. 897). Confirmation by Court:

The judge shall confirm a plan if satisfied that—

(2) the plan is fair and equitable, and feasible;

C. From Chapter XI:

SEC. 302 (11 U. S. C. 702; 52 Stat. 905). Applicability of other sections:

The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, apply in proceedings under this chapter. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors", and "bankruptcy proceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter.

SEC. 306 (11 U. S. C. 706; 52 Stat. 906). Definitions:

(1) "Arrangement" shall mean any plan of a debtor for the settlement, satisfaction, or extension of

the time of payment of his unsecured debts, upon any terms;

(3) "Debtor" shall mean a person who could become a bankrupt under Section 4 of this Act and who files a petition under this chapter;

SEC. 308 (11 U. S. C. 708; 52 Stat. 906). Creditors affected by arrangement; determination:

A creditor shall be deemed to be "affected" by an arrangement only if his interest shall be materially and adversely affected thereby. In the event of controversy, the court shall after hearing upon notice summarily determine whether any creditor is so affected.

SEC. 321 (11 U. S. C. 721; 52 Stat. 907). When petition may be filed:

A debtor may file a petition under this chapter in a pending bankruptcy proceeding either before or after his adjudication.

SEC. 322 (11 U. S. C. 722; 52 Stat. 907). Original petition:

If no bankruptcy proceeding is pending, a debtor may file an original petition under this chapter with the court which would have jurisdiction of a petition for his adjudication.

SEC. 324 (11 U. S. C. 724; 52 Stat. 907). Accessories to petition:

The petition shall be accompanied by

(1) A statement of the executory contracts of the debtor, and the schedules and statement of affairs, if not previously filed: . . .

SEC. 328, as added in 1952 (11 U. S. C. 728; 66 Stat. 432). Dismissal, proceedings; amended petition:

The judge may, upon application of the Securities and Exchange Commission or any party in interest, and upon such notice to the debtor, to the Securities and Exchange Commission, and to such other persons as the judge may direct, if he finds that the proceedings should have been brought under Chapter X of this Act, enter an order dismissing the proceedings under this chapter, unless, within such time as the judge shall fix, the petition be amended to comply with the requirement of Chapter X of this Act for the filing of a debtor's petition or a creditors' petition under such chapter, be filed. Upon the filing of such amended petition, or of such creditors' petition, and the payment of such additional fees as may be required to comply with Section 132 of this Act, such amended petition or creditors' petition shall thereafter, for all purposes of chapter X of this Act, be deemed to have been originally filed under such chapter.

SEC. 334 (11 U. S. C. 734; 52 Stat. 908). Meeting of creditors:

The court shall promptly call a meeting of creditors, upon at least ten days' notice by mail to the debtor, the creditors, and other parties in interest.

SEC. 338 (11 U. S. C. 738; 52 Stat. 909). Appointment of committee; nomination of trustee:

At such meeting the creditors may appoint a committee, if none has previously been designated or appointed under this Act, and, if a trustee has not previously been appointed, may nominate a trustee who shall thereafter be appointed by the court in case it shall become necessary to administer the estate in bankruptcy as provided under this chapter.

SEC. 363. (11 U. S. C. 763; 52 Stat. 911). Proposing alterations or modifications:

Alterations or modifications of an arrangement may be proposed in writing by a debtor, with leave of court, at any time before the arrangement is confirmed.

SEC. 366* (11 U. S. C. 766; 66 Stat. 433). Confirmation of arrangement:

The court shall confirm an arrangement if satisfied that—

(1) The provisions of this chapter have been complied with;

(2) It is for the best interests of the creditors and is feasible;

(3) The debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt; and

(4) The proposal and its acceptance are in good faith and have not been made or procured by any means, promises, or acts forbidden by this Act.

Confirmation of an arrangement shall not be refused solely because the interest of a debtor, or if the debtor is a corporation, the interests of its stockholders or members will be preserved under the arrangement.

SEC. 376 (11 U. S. C. 776; 52 Stat. 912). Dismissal and adjudication:

If the statement of the executory contracts and the schedules and statement of affairs, as provided by paragraph (1) of section 324 of this Act, are not duly filed, or if an arrangement is withdrawn or abandoned

* As amended by Act of July 7, 1952, Sec. 35—Public Law 456—82nd Cong., 2d Sess., effective Oct. 7, 1952.

prior to its acceptance, or is not accepted at the meeting of creditors or within such further time as the court may fix, or if the money or other consideration required to be deposited is not deposited or the application for confirmation is not filed within the time fixed by the court, or if confirmation of the arrangement is refused, the court shall—

(1) Where the petition was filed under section 321 of this Act, enter an order dismissing the proceeding under this chapter and directing that the bankruptcy be proceeded with pursuant to the provisions of this Act; or

(2) Where the petition was filed under section 322 of this Act, enter an order, upon hearing after notice to the debtor, the creditors and such other persons as the court may direct, either adjudging the debtor a bankrupt and directing that bankruptcy be proceeded with pursuant to the provisions of this Act or dismissing the proceeding under this chapter, whichever in the opinion of the court may be in the interest of the creditors.

Court Rules.

RULES OF THE U. S. DISTRICT COURTS FOR THE SOUTHERN AND EASTERN DISTRICTS OF NEW YORK; BANKRUPTCY:

RULE XI-2—Affidavits to be filed with petition

(a) Every petition for arrangement filed pursuant to Section 321 shall be accompanied by an affidavit of the debtor setting forth:

(1) Whether a receiver or trustee was appointed in the prior bankruptcy proceeding, and if so, the name of such receiver or trustee; whether or not a

creditors' committee was appointed under section 44(b) in the prior bankruptcy proceeding, and if so, the names and addresses of the members of such committee;

(2) the names and addresses of the ten largest creditors, excluding (a) those creditors who would not be entitled to vote at creditors' meetings under section 56(b); (b) such creditors as were employed by the debtor at the time of the filing of the petition; (c) creditors who are relatives of the debtor, or, if the debtor is a corporation, creditors who are stockholders or officers or members of the board of directors or trustees or other similar controlling bodies of such debtor corporation; and (d) creditors who have participated directly or indirectly in the act of bankruptcy as charged in the petition;

(3) the nature and present status of each action or proceeding pending or threatened against the debtor or his property, where a judgment against the debtor or the seizure of his property may be imminent; and

(4) a statement of all property of the debtor in the possession or custody of any public officer, receiver, trustee, assignee for the benefit of creditors, mortgagee, pledgee, or assignee of rents, giving the names and addresses of such persons and the court in which such proceedings, if any, are pending.

(b) If the petition is filed under section 322 the affidavit shall set forth the matters required by subsection (a) (2) (3) and (4) of this rule and shall also state whether the debtor is occupying any premises under a lease, and if he is, a statement as to the length of the term, the rent reserved, the amount owing for

rent, and what negotiations for a modification of the lease have been had, if any, with whom and the present status thereof.

RULE XI-4—Hearing on indemnity; first meeting

(a) *Hearing on Indemnity*

The court, after the filing of a petition under Section 322, shall cause a hearing to be held as soon as practicable, upon five days' notice by mail to the debtor, the debtor's attorney, those creditors whose names are listed in the affidavit filed by the debtor pursuant to the provisions of rule XI-2 and to such other parties in interest as the court may direct for the purpose of determining whether or not the debtor shall be required to file a bond or undertaking or deposit cash indemnity, or whether any other terms or conditions shall be imposed in accordance with sections 326, 342 and 343 of the Act.

(b) *First Meeting of Creditors*

In order to carry into effect the provisions of sections 334 to 338 of the Act, the court shall call the meeting of creditors within thirty days after the filing of the petition for arrangement and schedules or list of creditors.

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No. 170

IN THE

Supreme Court of the United States

OCTOBER TERM 1955

GENERAL STORES CORPORATION, PETITIONER

vs.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS' COMMITTEE and WAGE CLAIMANTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITIONER'S REPLY BRIEF

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ACKERMAN PRESS, Phones BO 9-7107-8

IN THE

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITIONER'S REPLY BRIEF

Corrections to Statement of the Case

1.

The Securities and Exchange Commission has depreciated the extent of the interest of the wage claimants in the present proceeding where they claim that their priority, secure in Chapter XI, will be lost by dismissal of these proceedings or transference to Chapter X. (See SEC brief n 23, page 41.)

The Referee, we are informed, has received wage claims aggregating $267,287.04 of which $90,807.60 has been assigned priority within the limit of $600 per claimant. (See also Wage Claimants' brief, p. 2.)

2.

The brief for the Securities and Exchange Commission characterizes petitioner's financial condition as "shaky" and in several places, as existing "for many years". (Brief, p. 3 says it relates "back at least to 1936"; see also p. 20.) Obviously, no debtor being in "sound financial condition" in the usual sense of paying its bills and preserving its capital would ever need to resort to any of the chapters of the Bankruptcy Act. It must be assumed, therefore, that the said respondents are not referring merely to the condition which gave rise to the present proceedings, but are implying something a great deal more.

In all fairness, therefore, it must be emphasized that, following a successful reorganization of petitioner in 1940, it is undisputed that petitioner had very profitable years during the war and thereafter. Since that time its financial difficulties have been economic, patent to all, including the SEC, and fully disclosed to its stockholders.

It must also be conceded that there is no evidence that petitioner has not been wise and correct in liquidating the unprofitable operation and buying up the profitable Ford-Hopkins and Stineway chains. By an aggregate purchase for $4,020,320.50 (Record 48a and 71a), debtor acquired net earnings before depreciation and taxes which for three years previous amounted to an average per year

of $679,000. (Record 41a). Since both these acquisitions were reported to stockholders through proxy statements cleared with the Securities and Exchange Commission, at a time when the petitioner's stock was registered with the SEC, any unfavorable implications with regard to such operations come very tardily from the Commission.

There is nothing whatsoever in the record which would support any implication but that the decision of management taken in 1953 and 1954 was sound and in the best interests of stockholders. The investing public is not affected. This was pointed out below by Judge Galston, 222 F. 2d at 238. He added the point that there was nothing here which required reorganizing.

Reply Argument

(a) Comparison Between the Adequacy of Chapter X and Chapter XI Can Be Made Upon the Basis of the Specific Plans.

The Commission's brief, at pages 10 and 26, presents the fallacious argument that since under Chapter X no "plan" is required at the outset of the proceedings, the comparative adequacy of the relief afforded in X with that afforded in Chapter XI cannot be made at the outset of the proceedings. The Commission's argument totally overlooks the initial statutory requirement in every Chapter X proceeding that the petition "shall state the specific facts showing the need for relief under this chapter and why adequate relief cannot be obtained under Chapter XI of this act." (Section 130(7) of the Bankruptcy Act.)

Obviously, it is incumbent upon the petitioner in Chapter X to state specific facts showing that petitioner requires relief beyond mere composition or arrangement with its unsecured creditors. Unless the facts shown exclude the possibility of relief obtainable by a debtor's petition under Chapter XI, the petition in Chapter X is, as a matter of law, filed in bad faith. (Section 146(2).)

In short, every petition in Chapter X which complies with the requirement of Section 130(7) and every petition in Chapter XI which complies with Section 323 to the extent of setting forth "the provisions of the arrangement proposed by him" affords the court ample facts for a comparison of the adequacy of relief afforded in that specific case under either chapter. On the one hand, the court can determine whether the petition in Chapter X has been improperly filed there because adequate relief can be obtained by the debtor's petition under Chapter XI. (See Section 147.) On the other hand, the court can determine whether the debtor's petition filed in Chapter XI is improperly filed there because adequate relief may not be obtained by the debtor's petition in that chapter and that debtor may have recourse under Chapter X. (See Section 328.)

The parallel structure and purpose of Sections 147 and 328 cannot be denied, since the avowed purpose of Congress in 1952 was to supply Section 328 in view of the lack of this provision corresponding to Section 147 of Chapter X. (See House Report quoted in our brief as Note to page 15.)

(b) It Was the Plan Which Was Decisive of the *U. S. Realty* Decision.

The Commission's brief, at page 25, fallaciously insists that the character of the debtor, rather than the plan proposed, was determinative of the *U. S. Realty* decision. (Compare the admission in Shlensky Brief, p. 9, and Judge Clark in the *Mecca Temple* case, 142 F. 2d at 872.) An analysis of the whole opinion of Mr. Justice Stone must demonstrate that the portion of the opinion quoted and referred to in our brief, page 11, based upon the failure of the plan on its face as contained in the petition to meet the fair and equitable test, was the determinative factor. We shall argue here only the matters of correlative legislative history upon which the Commission's brief relies.

In the first place, the Commission's brief argues, pages 34 and 35, that the withdrawal in Congress at the time of the *U. S. Realty* decision of a proposed amendment to Chapter XI to exclude from that chapter a corporation with 100 or more security holders in any one class constituted legislative interpretation of Mr. Justice Stone's opinion that the Bankruptcy Act needed no such amendment. To the contrary, Mr. Justice Stone's opinion pointed out that the Act does not define what is a large corporation. (310 U. S. at 447.) The deficiency in the Act was what Judge Frank hoped to supply by the court decision below (222 F. 2d 237.)*

Indeed, it ought to be conceded that the controversial question raised during the formative stages of the Chand-

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* See also Judge Clark's admission in the *Mecca Temple* case, 142 F. 2d 869 at 871, that "there is still no well-defined answer."

ler Act and referred to by Mr. Justice Roberts (see our brief, page 41) was still controversial during the period that the *U. S. Realty* case was in the courts (Commission's brief, page 34) and was not set at rest by the *U. S. Realty* case. (See the *Transvision case*, 217 F. 2d at 246, and Judge Frank's opinion below, 222 F. 2d 237 and *Mecca Temple* case, 142 F. 2d at 871.)

It is particularly important to note that this controversial question was not settled or even raised in the 1952 amendments to the Bankruptcy Act. As the Commission's brief is at pains to emphasize, there was nothing controversal about the 1952 amendment. (SEC brief, pp. 11 and 32.). On the one hand, it supplied in Chapter XI the lack of a provision corresponding to Section 147 of Chapter X. On the other hand, it re-enacted the rule that the primary standard of a composition or plan of arrangement was that it should be satisfactory to creditors rather than comply with any "fair and equitable" rule imported from equity receiverships or old Section 77B.

Certainly the "hot potato" as to whether the "character" of the debtor could exclude it from the benefits of Chapter XI was scrupulously avoided by Congress in enacting the 1952 amendments. If Congress was under the impression that the observations by Mr. Justice Stone on this subject in the *U. S. Realty* case constituted the basis of the decision of this court, and if Congress had any intention to "codify" such observations, it is perfectly obvious that the Commission's contentions in this case would have received Congressional enactment through the 1952 amendments.

Congress has never recognized the SEC's extreme contention in this and the *Transvision* cases. The interest

of general unsecured creditors, rather than common stockholders, continues to be the primary interest of the bankruptcy courts. Alteration of this point of view would require clear Congressional action.

In order that our position before this Court with respect to the important *U. S. Realty* case may be clearly understood, we point out:

(1) Because we believe that the basis of the *U. S. Realty* decision was the fact that under the law then in force, the plan could never obtain confirmation in Chapter XI, we think that case was correctly decided on the procedural point that the Court, faced with the inevitability that the Court was without power to confirm the plan, had a duty and power to shorten the abortive proceeding. Congress confirmed the power by the 1952 amendment.

(2) Because we believe that "fair and equitable" was imported by the original Chandler Act into Chapter XI where no corresponding phrase had appeared in the predecessor Section 12 for compositions, we think the *U. S. Realty* case was correctly decided in holding that such words in Chapter XI have the same meaning as given them in Chapter X and its predecessor Section 77B. That Congress by the 1952 amendments deleted the words and permitted proceedings in Chapter XI to be administered on the same standards for confirmation of a plan as that which had existed in its predecessor Chapter 12, confirms us in our opinion.

(3) Because we believe that Congress has since the formative stages of the Chandler Act been well aware of the contentions of the Securities and Exchange Commis-

sion that large corporations with public stockholders should be excluded from the benefits of Chapter XI, regardless of the plan or relief sought, we think that to the extent that Mr. Justice Stone implied concurrence with the contentions of the Commission, his observations were both unnecessary to the decision and incorrect. The failure of Congress to enact or codify the contentions of the SEC in this regard confirms us in our opinion.

(4) To the extent that in a Chapter XI proceeding the debtor proposes to modify the rights contained in publicly distributed debt securities, as was the exact case in *U. S. Realty*, we believe the Court might be faced with the necessity of deciding a conflict between the public policy, as expressed in the Securities Act of 1933 and the public policy as expressed in Section 146(2) of the Bankruptcy Act. To the extent, therefore, that the *U. S. Realty* plan sought to modify the publicly-held debt security, we think that Mr. Justice Stone's preoccupation with the public interest, in that case to be protected by the SEC, may well have been correct.* However, Congress has not even codified this aspect of the *U. S. Realty* case. The issue does not exist at all in the *General Stores* case because only trade and commercial debts are intended to be affected.

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* The SEC brief, page 33, misunderstands our position in this regard. We neither urge that the *Realty* decision be swept aside, nor admit that reversal in this *General Stores* case would mean that a debtor with publicly-held debentures could deprive such holders of their right to absolute priority in a proceeding under Chapter XI. For that reason the Shlensky brief, page 11, is in error for implying that we believe that absent the "fair and equitable" rule, the *Realty* decision might not have come to the same conclusion because publicly-held debt securities were planned to be adversely affected.

CONCLUSION

The *U. S. Realty* case is not controlling of this case, not because the *U. S. Realty* case was incorrectly decided or because Congress changed the law with express reference to that decision, but rather, because the Court was not faced in the *U. S. Realty* case with the issue raised in this case.

In this case there are no publicly distributed and held debt securities and the only persons affected by the proposed plan are unsecured trade and commercial creditors. The Court may not, in the absence of any allegations or proof that irreparable harm might be expected from a continuance of these proceedings, simply dismiss the proceedings because the debtor is a large corporation having public stockholders.

Certainly that was not the question which faced this Court in the *U. S. Realty* case. In accepting the argument that the *U. S. Realty* decision is controlling in the present case, the courts below were in error and the decisions should be reversed.

Respectfully submitted,

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January 16, 1956.

SUPREME COURT, U.S.

Office - Supreme Court, U.S.
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No. 170

In the Supreme Court of the United States

OCTOBER TERM, 1955

GENERAL STORES CORPORATION, PETITIONER

v.

MAX SHERBET AND THE SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

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In the Supreme Court of the United States

OCTOBER TERM, 1955

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v.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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OPINIONS BELOW

The opinions of the Court of Appeals (Pet. App. 1a–11a) are reported at 222 F. 2d 234. The opinion of the District Court is reported at 129 F. Supp. 801.

JURISDICTION

The judgment of the Court of Appeals (Pet. App. 8a–9a) was entered on April 14, 1955. The petition for a writ of certiorari was filed on June 22, 1955. The jurisdiction of this Court is invoked under 28 U. S. C. 1254 (1).

QUESTION PRESENTED

Whether a corporate debtor with assets of about $5,000,000, approximately 7,000 stockholders, and over 2,000,000 shares of common stock actively traded on a national securities exchange, may utilize the arrangement procedure of Chapter XI of the Bankruptcy Act or whether it must use the corporate reorganization procedure of Chapter X.

STATUTE INVOLVED

Section 328 of the Bankruptcy Act provides:

> The judge may, upon application of the Securities and Exchange Commission or any party in interest, and upon such notice to the debtor, to the Securities and Exchange Commission, and to such other persons as the judge may direct, if he finds that the proceedings should have been brought under chapter X of this Act, enter an order dismissing the proceedings under this chapter, unless, within such time as the judge shall fix, the petition be amended to comply with the requirement of chapter X for the filing of a debtor's petition or a creditors' petition under such chapter, be filed. Upon the filing of such amended petition, or of such creditors' petition, and the payment of such additional fees as may be required to comply with section 132 of this Act, such amended petition or creditors' petition shall thereafter, for all purposes of chapter X of this Act, be deemed

to have been originally filed under such chapter. [11 U. S. C. 728; 66 Stat. 432]

STATEMENT

The order which the petitioner seeks to review affirmed an order of the District Court for the Southern District of New York granting the motions of this Commission and of Max Shlensky, a stockholder of the debtor (petitioner here), for dismissal of a petition filed by the debtor under Chapter XI of the Bankruptcy Act unless it should be amended to comply with Chapter X. (R. 2a, 3a). The Securities and Exchange Commission had been granted leave to intervene for the purpose of making the motion.

From its inception in 1915 until recently, the debtor (under its former name of D. A. Schulte, Inc.) was in the business of operating chain stores for the sale of tobacco and accessory products. New management installed in 1951 effected a change in the debtor's business in 1953 and 1954 by the purchase of the outstanding capital stock of two corporations engaged primarily in the operation of retail drug stores and by the subsequent discontinuance of the debtor's Schulte-type stores. In the five years and five months ended March 31, 1954, the debtor's aggregate losses exceeded $4,200,000 (R. 30a–32a).

The debtor's Chapter XI petition was filed on October 18, 1954. It proposed an arrangement whereunder its unsecured creditors would receive

the face amount of their claims over a five-year period. The debtor's schedules at that time listed assets of about $4,900,000 and liabilities of about $3,900,000 (R. 41a).

The debtor has outstanding 2,232,422 shares of $1 par value common stock. Of these, about 127,000 shares are owned by directors and officers, and the balance are owned by upwards of 7,000 widely scattered shareholders. The debtor's shares are listed and are actively traded on the American Stock Exchange (R. 30a). As of July 21, 1954, 596,079 of the debtor's shares had been issued pursuant to a registration statement filed in 1952 with the Securities and Exchange Commission. The major portion of the balance had previously been issued pursuant to the terms of a plan of reorganization adopted under Section 77B of the Bankruptcy Act from which reorganization the debtor emerged in 1940 (R. 30a–31a).

DISCUSSION

It is the position of the Securities and Exchange Commission that the order which petitioner asks this Court to review is correct since Congress did not intend to permit corporate debtors with securities widely held by the public to utilize the bankruptcy procedures provided by Chapter XI. Chapter X alone provides the necessary investigative and analytical procedures to deal effectively with financial and management problems of such corporations; it alone vests in

the Bankruptcy Court the necessary powers to effectuate a sound reorganization and provides the necessary protection for public investors.

Although in the present case it is argued that the proposed arrangement affects only unsecured creditors, it is obvious that it may adversely affect the public stockholders since its use, instead of Chapter X proceedings, deprives them among other things of an independent investigation by a disinterested trustee which might reveal the necessity of changes in management or plans of operation, or even that the debtors' continuation will merely postpone inevitable liquidation. In the meantime, if a Chapter XI arrangement is consummated without consideration of these matters, assets now available for public security holders may disappear and causes of action which investigation under Chapter X might disclose may be lost.

In *Securities and Exchange Commission* v. *United States Realty and Improvement Co.*, 310 U. S. 434, this Court reversed the determination of two lower courts that an arrangement under Chapter XI might be utilized by the corporation there involved, which had several classes of public investors, and held that only Chapter X could be resorted to in view of the protections for public investors there provided. This Court referred to Chapter XI as especially suited for a "small individual or corporate business where there are no public or private interests involved requiring

protection by the procedure and remedies afforded by Chapter X." (310 U. S. at 449, 454). The Court further noted that, "The basic assumption of Chapter X and other acts administered by the Commission is that the investing public dissociated from control or active participation in the management, needs impartial and expert administrative assistance in the ascertainment of facts, in the detection of fraud, and in the understanding of complex financial problems." (*Id.* fn. 6, at 448–449).

United States Realty was followed by the court below in *Mecca Temple* v. *Darrock*, 142 F. 2d 869, certiorari denied, 323 U. S. 784. That case involved a membership corporation with 2,800 members and with bonds held by 1,834 persons. The debtor was not permitted to utilize Chapter XI.

The petitioner in this case attempts to distinguish *United States Realty* and *Mecca Temple* on the ground that the public investors in those cases held debt securities whereas the public investors here are stockholders. There is nothing in the language of *United States Realty* or in its reasoning which would limit its application to publicly-held debt securities. The protective provisions of Chapter X which this Court summarized in the *United States Realty* case (310 U. S. at 449–450) are necessary to safeguard all public investors, including stockholders.

In a relatively recent case, *In the Matter of Transvision, Inc.* 217 F. 2d 243, certiorari denied, 348 U. S. 952, a panel of the court below, differing from the panel which heard the present case, upheld a district court order refusing to dismiss a Chapter XI proceeding involving a corporate debtor owned in part by public investors. The court in that case indicated that the nature of the plan and the absence of evidence of irregularities by the management made Chapter XI appropriate. The Commission believed this decision inconsistent with *United States Realty* and petitioned for certiorari, but, as indicated above, the petition was denied.[1]

We believe that the differences between this case and *Transvision, Inc.*, just mentioned, are differences in degree. Two of the judges deciding the instant case found it difficult to reconcile the decisions in the two cases, although Judge Frank apparently thought them distinguishable. We asserted in our petition in *Transvision, Inc.* that

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[1] The petitioner here cites *John Hancock Mutual Life Insurance Co.* v. *Casey*, 141 F. 2d 104 (C. A. 1), certiorari denied, 323 U. S. 713, as a case in conflict with the decision below (Pet. 9). An examination of that case, however, demonstrates that the court merely dismissed a Chapter X proceeding upon the ground that a reorganization under Chapter X was "either unnecessary or impossible." Although the court indicated that after dismissal the district court might entertain a motion to amend the petition to comply with the requirements of Chapter XI, this was not necessary to the decision.

the issue was an important one justifying review by this Court. Since the decision in that case, the question of whether Chapter X or Chapter XI was appropriate has arisen in several additional cases.

CONCLUSION

Although the Commission believes the decision of the court below is correct, because of the importance of the question involved and the possible inconsistency in the decisions of the court below, it does not oppose the granting of the petition for a writ of certiorari.

Respectfully submitted.

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JULY, 1955.

U. S. GOVERNMENT PRINTING OFFICE: 1955

No. 170

FILED
AUG 12 1955
HAROLD B. WILLEY,

IN THE

Supreme Court of the United States

OCTOBER TERM 1955

In the Matter of Proceedings for an Arrangement Under Chapter XI of the Bankruptcy Act

of

GENERAL STORES CORPORATION,
Debtor-Petitioner,

v.

MAX SHILENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS COMMITTEE and WAGE CLAIMANTS,
Respondents.

MEMORANDUM ON BEHALF OF THE CREDITORS COMMITTEE

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In the Matter of Proceedings for an Arrangement Under Chapter XI of the Bankruptcy Act

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GENERAL STORES CORPORATION,

Debtor-Petitioner,

v.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS COMMITTEE and WAGE CLAIMANTS,

Respondents.

MEMORANDUM ON BEHALF OF THE CREDITORS COMMITTEE

The Creditors Committee joins with the Debtor-Petitioner, General Stores Corporation, in praying that a Writ of Certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Second Circuit dated April 14, 1955, which by a divided court affirmed the judgment of the United States District Court for the Southern District of New York entered on March 7, 1955. The decision of the Court below is that Chapter XI of the Bankruptcy Act is not available to corporations whose stock is publicly held.

Statement

On October 18, 1954, General Stores Corporation filed a petition in the District Court for the Southern District of New York, in accordance with the provisions of Section 322* of Chapter XI of the Bankruptcy Act, in which it proposed an arrangement of its general unsecured obligations (R. 13a). Under the plan, such creditors would receive 100% of their claim, 20% upon confirmation of the plan and 20% annually thereafter. Statutory priority creditors would be paid in full (R. 14a).

Prior to the filing of the Chapter XI petition, General Stores Corporation conducted a chain of retail cigar stores (R. 42a). It also purchased and still owns the entire capital stock of Stineway Drug Company and Ford Hopkins Company, which companies operate drug-restaurant chains in Chicago and mid-western States (R. 37a). All of the capital stock of these subsidiaries is held by the seller under a trust agreement, as security for the payment of the balance of the purchase price, approximately $2,000,000 (R. 43a, 46a).

The debtor's capital structure consists of a little over 2,000,000 shares of $1.00 par common stock held by approximately 7,000 stockholders and listed on the American Stock Exchange (R. 30a). It has only one class of stockholders (R. 43a) and two classes of creditors, namely, priority creditors (in the main, for wages and taxes) and general unsecured creditors (in the main, merchandise creditors, former employees and landlords on rejected leases) (R. 40a, 42a).

During the administration of these proceedings the debtor rejected all of its existing executory lease agreements covering its retail cigar stores and converted into cash all of its merchandise inventory, fixtures and equipment, so

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*11 U. S. C. 722; 52 Stat. 907

that the assets of the debtor now consist solely of (1) cash on hand and (2) all of the capital stock of the aforementioned subsidiaries (R. 54a).

In the course of these proceedings it became apparent that the assets of the debtor would not permit the payment to unsecured creditors of the full amount of their claims. The debtor proposed to the Creditors Committee to pay the equivalent of 40% of the unsecured creditors claims in full satisfaction thereof, payable 10% in cash and 30% in shares of the debtor's common stock. This proposal has received the approval of a majority of the official creditors committee.*

Reasons for Granting the Writ

There are several substantial reasons for the issuance of a Writ of Certiorari to review the judgment of the Circuit Court of Appeals.

The Court below has declared that a debtor whose stock is listed on an exchange and publicly held may not compose its unsecured obligations unless it resorts to the elaborate investigatory procedures involved in a reorganization pursuant to Chapter X of the Bankruptcy Act. This concept is unwarranted under the provisions of the Bankruptcy Act and the previous decisions of this and other courts and is the result of a misinterpretation of the holding of this Court in the *U. S. Realty* case.†

(1) In the *U. S. Realty* case the debtor had assets of $7,076,515 and liabilities of $5,051,416, of which only $74,916 was current. This indebtedness included two series of

*The statement of the case is not a complete exposition of the proceedings below but has been abbreviated pursuant to Rule 40, subdivision 3 of the Revised Rules of Court.

†*Securities and Exchange Commission v. U. S. Realty & Improvement Co.*, 310 U. S. 434.

publicly held debentures aggregating $2,339,000, which were secured by corporate stock, and a $3,000,000 note secured by a first mortgage held by the debtor. The debtor was also liable as a guarantor of mortgage certificates in the sum of $3,710,500 issued by its wholly-owned subsidiary and held by some 900 holders. It was this latter obligation which the debtor sought to modify by a plan pursuant to Chapter XI.

This Court, limiting its decision to the particular situation presented,* held that the question whether any "fair and equitable" arrangement could be effected without readjustment of the capital structure of the debtor could best be answered in a Chapter X proceeding.

In the first instance it is noted that the debt structure of the Debtor-Petitioner in the present case is dissimilar to that of the debtor in the *U. S. Realty* case. The present debtor does not have any debentures, bonds, mortgages, notes or any like obligations in the hands of the general public. It has but one class of stockholders. Indeed, the entire corporate structure of the Debtor-Petitioner is one of complete simplicity.

Secondly, the decision in the *U. S. Realty* case is based upon the law as it then existed that any plan of arrangement under Chapter XI had to meet the "fair and equitable" standard. At 310 U. S. 434, 452, the Court wrote:

> "'Fair and equitable', taken from § 77B and made the condition of confirmation under both Chapter X or Chapter XI are 'words of art' having a well understood meaning in reorganizations in equitable receiverships and under § 77B which is incorporated in the structure of both Chapters X and XI. See Case v. Los Angeles Lumber Products Co., 308 U. S. 106, 115 et seq., 60 S. Ct. 1, 7, 84 L. Ed. 110. The phrase signifies that the plan or arrangement must conform to the rule of Northern Pacific Ry. Co. v. Boyd, 228 U. S.

* *Securities & Exchange Commission v. U. S. Realty & Improvement Co.*, 310 U. S. 434, 454 (1940).

482, 33 S. Ct. 554, 57 L. Ed. 931, which established the principle which we recently applied in the Los Angeles case, *that in any plan of corporate reorganization unsecured creditors are entitled to priority over stockholders to the full extent of their debts and that any scaling down of the claims of creditors without some fair compensating advantage to them which is prior to the rights of stockholders is inadmissible.*" (Emphasis ours.)

In 1952 Congress amended Section 366 of the Bankruptcy Act* and eliminated the requirement that a plan of arrangement be "fair and equitable". The House of Representatives, in its report accompanying amendatory Bill S2234 (House Report No. 2320, 82nd Cong., 2nd Sess., in substance being the same as Senate Report No. 1395), said (2 U. S. Cong. & Adm. News '52, 1981):

"These sections (Secs. 366, 472 and 656a) presently require a finding that a proposed plan under chapters XI, XII, and XIII shall be 'fair and equitable'. In fact, however, the fair and equitable rule, as interpreted in Northern Pacific Railway Co. v. Boyd, 228 U. S. 482, 33 S. Ct. 554, 57 L. Ed. 931 (1913) and Case v. Los Angeles Lumber Products Co. Ltd., 308 U. S. 106, 41 Am. B. R. (N. S.) 110, 60 S. Ct. 1, 84 L. Ed. 110 (1939), cannot realistically be applied in a chapter XI, XII, or XIII proceeding.

"Chapter XI has replaced the old composition procedure under former section 12 of the Bankruptcy Act, where the fair and equitable rule did not apply. Nor is it practicable or realistic to apply the rule in a proceeding under chapter XI, XII, or XIII.

"The proposed amendment is designed to remove the fair and equitable provision, and by the paragraph added to each of the amended sections † it is made

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*11 U. S. C. 766; 66 Stat. 433.

†The following paragraph was added to Section 366: "Confirmation of an arrangement shall not be refused solely because the interest of a debtor, or if the debtor is a corporation, the interests of its stockholders or members will be preserved under the arrangement."

clear that the rule of the Boyd and Los Angeles cases shall not be operative under those three chapters." (Interpolation ours.)

This renunciation by Congress of the rule laid down in the *Boyd* and *Los Angeles* cases, which prompted the majority decision in the *U. S. Realty* case, would appear to give greater credence to the minority decision. Judge Roberts in his dissent (concurred in by the then Chief Justice Hughes and Mr. Justice McReynolds) said (p. 464):

> "The Act will be searched in vain for any hint of such a distinction (the contention of S.E.C. that Chapter X applies to corporations whose securities are held by the public, while Chapter XI applies to close corporations). Small corporations are permitted to avail themselves of Chapter X if stockholders' or secured creditors' rights are to be affected; large corporations, under the very letter of Chapter XI, may avail themselves of its provisions *if all they desire to do is to extend or accommodate their unsecured indebtedness.* The smallest corporation cannot come in under Chapter XI if it desires what has been traditionally known as a reorganization. *The largest corporation may proceed under Chapter XI if it does not desire a reorganization.*" (Interpolation and emphasis ours.)

(2) The *Mecca Temple* case* is also relied upon by the Court below as determinative of the issues involved in the present case. In that case the debtor, a membership corporation, was obligated in the sum of $1,200,000 principal and interest as a result of a bond issue in the principal amount of $763,000. It proposed to pay each unsecured bondholder, 1,834 in number and located throughout the country and not necessarily all members of the debtor, 10% of the principal amount of his outstanding bonds in installments of 1% per year for ten years, without interest. At 142 F. 2d 869, 871, the Court wrote:

Mecca Temple of Ancient Arabic Order of Nobles of Mystic Shrine v. Darrock, 2 Cir., 142 F. 2d 869, certiorari denied 323 U. S. 784

"Of course, there still is no well-defined answer in the borderline cases to the question as to whether a particular type corporation should be permitted to proceed under Chapter XI; but especially persuasive here is the nature of the debtor's financial structure, which is such that if a reorganization under Chapter X is not required, the interests of an objecting creditor like appellant are not likely to be adequately protected. We have seen that the annual income of the debtor is well in excess of $50,000, while disbursements total less than $15,000 (a sum which appellant urges could easily be substantially reduced); and yet there is no explanation of the use to which the balance of the receipts is being put. Some explanation is surely due the creditors before they should be obliged to accept 10 cents on the dollar for their principal and nothing at all for their long overdue interest. Should the plan of arrangement proposed in the petition be confirmed, the debtor would be able to liquidate its indebtedness for $7,630 per year for ten years—a result palpably unjust to the unsecured creditors of a corporation whose income appears to exceed its authorized expenditures by nearly $40,000 yearly. These facts by themselves suggest that the plan merits condemnation under Bankruptcy Act, § 366(2), which states that the court shall confirm an arrangement only if it is convinced that 'it is for the best interests of the creditors'."

In addition to finding the proposed plan "palpably unjust", the Court also followed the *U. S. Realty* case with respect to the "fair and equitable" rule and found a further reason to direct a transfer to Chapter X by applying the rule of the *Boyd* case. There has been nothing to indicate that the proposed arrangement in the present case is unjust or inequitable. The *Mecca Temple* case is, therefore, inapplicable on its facts to the present case and, in any event, its value as a precedent is, along with the *U. S. Realty* case, seriously affected by the 1952 amendment to the Bankruptcy Act, which deleted the "fair and equitable" requirement.

(3) In the *Transvision* case*, a different panel of the Court below, in a substantially similar situation, affirmed an order of the District Court which denied an application by the Securities and Exchange Commission for a dismissal of the Chapter XI proceeding and its conversion into a Chapter X proceeding. At 217 F. 2d 243, 247, Judge Medina, speaking for the Court, wrote:

> "The SEC has adduced no information which would tend to indicate that the plan is likely to fail, but has, at most, indicated that there may be some basis for suspecting possible improprieties in past management. Certainly, so ephemeral a suspicion is not an adequate basis upon which to overturn a plan which the District Court, on the facts before it at this time, appears to believe may ultimately be found feasible, and one which, necessarily, would have to be acceptable to at least a majority of the unsecured creditors before being approved."

In the present case there has not been even the slightest intimation of any wrongdoing which would require the protective features of a Chapter X proceeding.† Moreover, as in the *Transvision* case, the proposed arrangement "may well enure to the ultimate advantage of the petitioner and its stockholders" (217 F. 2d 243, 247). The failure of the Court below to follow the *Transvision* case further confused the situation with respect to the circumstances under which a corporate debtor may resort to Chapter XI and is still another reason for the granting of a writ of certiorari in the present case.

(4) It is important to point out that under Section 366 of the Bankruptcy Act,‡ as amended in 1952, the funda-

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* *In re Transvision, Inc.*, 217 F. 2d 243, certiorari denied 348 U. S. 952.

† Indeed, as stated by Judge Galston in his dissenting opinion below (Pet. App. 6a, 8a), redress for any wrong, if such were charged, may be had under the Laws of the State of New York, the domicile of the Debtor-Petitioner.

‡ 11 U. S. C. 766; 66 Stat. 433.

mental requisite for the confirmation of a plan of arrangement pursuant to Chapter XI is that the plan be "for the best interests of the creditors". The creditors must be accorded primary consideration, and it is respectfully submitted that the interests of the creditors would be best served by a continuance of the proceeding in Chapter XI, rather than Chapter X. A transfer of these proceedings to Chapter X would require the appointment of a trustee who, to the extent directed by the Court, would be obliged to undertake an examination and investigation of the Debtor-Petitioner's liabilities, property, management and numerous other matters relevant to the formulation of a plan. Such measures are totally unnecessary, for the Creditors' Committee conducted an extensive examination into the affairs of the Debtor-Petitioner and there has been no charge of fraud or impropriety. To compel a transfer to Chapter X, in order to incorporate the investigatory procedures of that chapter, will only result in delay and dissipation of the assets of the Debtor-Petitioner, without deriving the benefits those procedures were designed to afford.

On the other hand, reversal of the judgment below and a continuance of the Chapter XI proceeding will permit the Debtor-Petitioner and its general, unsecured creditors to effect a settlement which would, in all probability, result in the creditors receiving 70% of their claim in cash and 30% in shares of common stock of the Debtor-Petitioner. As previously noted, this proposal received the approval of a majority of the Creditors Committee, for if a plan of arrangement may be concluded without delay and the enterprise continued with the Debtor-Petitioner free of its unsecured debts, the value of the stock received by the creditors will appreciate and substantially reduce the loss which the creditors would otherwise sustain. Such a proposal is likewise in the best interests of the stockholders of the Debtor-Petitioner, for confirmation of a plan of arrangement pursuant to Chapter XI will result in an

increase in the value of the stock of the company and the preservation of the stockholders' $2,000,000 investment in its two subsidiaries, Stineway Drug Company and Ford Hopkins Company:

(5) Despite the economic advantages of permitting the present proceedings to remain in Chapter XI, the decision below directs a transfer to Chapter X. The Debtor-Petitioner does not seek nor require reorganization.* Indeed, the decision of the Court below recognizes that the company's present corporate structure is not overly complicated.† Yet, despite the absence of a need for reorganization, the judgment below directs a transfer of the proceedings to Chapter X, apparently solely on the ground that the debtor is a corporation whose stock is publicly held, which was also the situation in the *Transvision* case.

(6) It should be noted that a transfer of the proceedings to Chapter X, with the resultant expense and delay, is not necessary in order to incorporate into the present proceedings procedural safeguards similar to those provided for in Chapter X.

Section 357 of the Bankruptcy Act‡ provides as follows:

"An arrangement within the meaning of this chapter may include—

* * * * * * *

"(7) provisions for retention of jurisdiction by the court until provisions of the arrangement, after its confirmation, have been performed; and

"(8) any other appropriate provisions not inconsistent with this chapter."

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* See opinion of Galston, D. J. (Pet. App. 6a, 8a)

† See opinion of Clark, C. J. (Pet. App. 2a)

‡ 11 U. S. C. 757; 52 Stat. 910

Protective provisions comparable to the procedures of Chapter X may therefore be included, such as the following: (1) an independent audit by auditors approved by the Securities and Exchange Commission; (2) the submission of such report to the Commission and to the Court; (3) retention of jurisdiction of the proceeding by the Court with power to make such orders as may be appropriate; and (4) distribution to the creditors and stockholders of the Commission's comments with regard to any proposed plan. Thus, the protective features of Chapter X may be combined with the speed and economy of Chapter XI so that a plan of arrangement of the general unsecured debts of the Debtor-Petitioner, which is all the Debtor-Petitioner requires, may be affected without the delay and dissipation of assets which must occur upon a transfer of these proceedings to Chapter X.

The Creditors Committee earnestly urges that the Court below in denying the Debtor-Petitioner access to Chapter XI and compelling a transfer to Chapter X, was in error. The holding of the Court below that a corporate debtor with publicly held stock may not resort to Chapter XI, when all that is sought is a composition of the debtor's unsecured obligations, has seriously affected the interests of the creditors of the Debtor-Petitioner and created a situation in which there is grave doubt as to the circumstances which require a debtor to resort to a reorganization pursuant to Chapter X. The issues involved in the present case are of vital importance and the apparent conflict between this case and the *Transcision* case should be definitively resolved by this Court.

Conclusion

For the foregoing reasons, a writ of certiorari should issue.

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IN THE

Supreme Court of the United States

OCTOBER TERM 1955

In the Matter

of

Proceedings for an Arrangement Under Chapter XI of the Bankruptcy Act of

GENERAL STORES CORPORATION,

Debtor-Petitioner.

v.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS COMMITTEE and WAGE CLAIMANTS,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM 1935

In the Matter

of

Proceedings for an Arrangement Under Chapter XI of the Bankruptcy Act of

GENERAL STORES CORPORATION,

Debtor-Petitioner,

v.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS COMMITTEE and WAGE CLAIMANTS,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Questions Presented

1. Whether a corporation irrespective of size, stock distribution, debt structure and financial history has the absolute right to proceed initially under Chapter XI of the Bankruptcy Act by proposing a plan affecting general unsecured creditors.

2. Whether the District Court has discretionary power to determine at the outset that Chapter XI is not avail-

able to a corporation by reason of its size, the widespread diffusion of its stock and its financial history and to direct that such corporation proceed under Chapter X of the Bankruptcy Act.

Statement

The debtor, a New York corporation, filed a petition under Section 322 of Chapter XI of the Bankruptcy Act on October 18, 1954. It proposed, at that time, a plan of arrangement affecting its general unsecured obligations in accordance with the requirements of Chapter XI (R. 13a).

The debtor has an authorized issue of three million shares of common stock. There are 2,232,422 shares of the common stock of the corporation held by some 7,000 stockholders (R. 30a). Its stock is listed on the American Stock Exchange and is actively traded there (R. 30t).

The assets of the debtor are listed at about $5,000,000.00 and its liabilities at about $4,000,000.00 (R. 34a and 35a). For the past five years, the debtor has sustained losses totalling about $4,000,000.00.

Under the name of D. A. Schulte, Inc., the name under which the debtor was originally incorporated, the debtor filed a petition for re-organization under Section 77b of the Bankruptcy Act. Until 1953, the debtor was engaged in the business of operating a chain of tobacco stores. At the time of the filing of the petition under Chapter XI of the Bankruptcy Act, the debtor operated some seventy-six tobacco stores. It appears, however, that as of July 1, 1954, the debtor operated one hundred forty-six stores. Since the date of the filing of the Chapter XI petition, the debtor has liquidated and discontinued operation of all of such stores.

The debtor is also the owner of all the outstanding stock of Stineway Drug Company which operates a chain of twenty-three stores in the Chicago area engaging in the sale of tobacco products, candy, liquor and drug sundries. These stores also operate fountains and luncheonettes. In addition, Stineway Drug Company sells merchandise to twelve independent drug stores which are identified as Stineway System Stores (R. 21a).

Debtor also owns all the outstanding stock of Ford Hopkins Company, a corporation engaged in the operation of a chain of forty-eight drug stores and three restaurants principally located in the City of Chicago.

The purchase price of the Stineway Drug Company stores was $1,220,320.50 of which $800,000.00 was paid in cash at the time of closing and the balance was to be paid by April 15, 1954 (R. 21a). The Ford Hopkins Company stock was acquired at a price of $2,800,000.00 of which $735,000.00 was paid at the time of closing. This down payment was paid in part from the proceeds of a loan from Stineway Drug Company amounting to $440,000.00.

Upon the petition of the respondent, Max Shlensky, the owner of some 3,000 shares of the stock of the debtor, an order was made by the District Court directing the debtor to show cause why the Chapter XI proceedings should not be dismissed unless the petition was amended to comply with the requirements of Chapter X for the filing of a petition for re-organization. The Securities Exchange Commission was made a party to the proceedings commenced by the respondent, Max Shlensky. Subsequently, the Securities Exchange Commission cross-moved for the same relief requested by the respondent, Max Shlensky.

Reasons for Denying the Writ

Despite the assertions of the debtor, the circumstances of this case do not give rise to any unsettled or undecided questions of law. This Court, in *Securities and Exchange Commission* v. *United States Realty & Improvement Co.*, 310 U. S. 434, precluded the unfettered exercise of choice between Chapter X and Chapter XI by corporate debtors. Certain criteria for such choice between Chapter XI and Chapter X were fixed in that case and within the limits so set it rests with the District Court in the exercise of sound discretion to determine whether a Chapter XI petition filed by a corporate debtor is proper or not.

The debtor denies that any such criteria exists in the present circumstances and indirectly states that if such criteria does exist, they are contrary to the provisions of the Bankruptcy Act.

Debtor attempts to distinguish the *U. S. Realty* case and the decision of the lower court in *Mecca Temple* v. *Darrock*, 142 F. (2d) 869, on the ground that in both of these cases the Courts were concerned with public investors in the capacity of creditors rather than stockholders. Any such attempted restriction does violence to the very language of the decisions.

This Court stated (p. 447):

> "While we do not doubt that in general, as will presently appear more in detail, the two chapters were specifically devised to afford different procedures, the one adapted to the reorganization of corporations with complicated debt structures and many stockholders, the other to composition of debts of small individual business and corporations with few stockholders, we find in neither chapter any definition or classification which would enable us

> to say that a corporation is small or large, its security holders few or many, or that its securities are 'held by the public', so as to place the corporation exclusively within the jurisdiction of the court under one chapter rather than the other."

and again:

> "Obviously the adequacy of the relief under Chapter XI must be appraised in comparison with that to be had under Chapter X, and in the light of its effect on all the public and private interests concerned including those of the debtor."

The debtor states that the fact that it has 7,000 stockholders is immaterial. It also considers the fact that it is a corporation with $5,000,000.00 in assets and $4,000,000.00 in liabilities equally immaterial. These are, however, the very facts upon which this case must turn. In the *U. S. Realty* case, this Court expressly stated that the size of a corporate debtor, the existence of public stockholders and the number of such stockholders determine whether or not a corporate debtor properly proceeded initially under Chapter X.

In the more recent case of *In Re Transvision, Inc.*, 217 F. (2d) 243, the Court below by another panel had occasion to pass upon a question substantially identical with the one here presented. In accordance with the decision in the *U. S. Realty* case, the Court below felt itself bound to determine whether there had been a proper exercise of discretion on the part of the District Judge in finding that a Chapter XI petition filed by the corporate debtor was proper. There, however, the Court was dealing with a relatively small corporation with an extremely limited number of stockholders. Although finding in favor of the corporate debtor, the Court below noted (p. 246):

> "In this connection, it may be observed that the more complex the debt structure and diffuse the stock distribution, the greater the likelihood that Chapter XI will not afford adequate protections and the greater the impulsion to relegate the petitioner to the relief afforded him under Chapter X. *Securities Commission* v. *U. S. Realty Co.*, 310 U. S. 434 (1940); *Mecca Temple, Etc.* v. *Darrock*, 142 F. 2d 869 (2 Cir. 1944)."

The need for the safeguards provided by Chapter X are underscored by the facts. The debtor is a corporation with 7,000 stockholders. Management is thus totally divorced from ownership. The debtor's history of losses of over $4,000,000.00 within the past 5 years compels an investigation into management of the business. The manner in which it obtained stock interest in two other large retail businesses also calls for close scrutiny. None of this can be obtained under Chapter XI.

The Antendatory Acts of 1952, upon which the debtor heavily relies, did not serve to modify or alter the criteria fixed in the *U. S. Realty* case and applied thereafter in the *Mecca Temple* and *Transvision* cases. In amending Section 366 of the Bankruptcy Act by deleting the "fair and equitable" requirement, Congress took cognizance of the warning issued by this Court in the *U. S. Realty* case that Chapter XI plans of arrangement would have to satisfy the "fair and equitable" test as fixed in *Northern Pacific Railway Company* v. *Boyd* (228 U. S. 482). This threatened to impair seriously the effectiveness of Chapter XI.

In the Congressional Report which accompanied the amendment to Section 366, it was noted as follows:

> "However, the fair and equitable rule cannot be applied in a chapter XI, XII, or XIII proceeding, if construed as interpreted in Northern Pacific Rail-

way Co. v. Boyd (228 U. S. 482, 33 S. Ct. 554, 57 L. Ed. 931 [1913], and reaffirmed in Case v. Los Angeles Lumber Products Co., Ltd. (308 U. S. 106, 41 Am. B. R. [N. S.] 910, 60 S. Ct. 1, 84 L. Ed. 110 [1939]), without impairing, if not entirely making valueless, the relief provided by these chapters. If so applied, no individual debtor or corporate debtor (where stock ownership is substantially identical with management) under chapter XI, and no individual debtor under chapter XII or XIII can effectuate an arrangement or plan by scaling of debts.

"The fair and equitable rule was never applied in a composition proceeding under the former section 12 of the Bankruptcy Act, which has been replaced by chapter XI, nor is it practicable or realistic to apply it in a proceeding under chapter XI, XII or XIII.

"The amendment removes the 'fair and equitable' provision and by a paragraph added to each of the amended sections it is made clear that it shall not be applied thereunder." 1952 U. S. Code Congressional and Administrative News 1981 and 1982.

By the very language of the Congressional Report, Chapter XI was consigned to its proper role, namely, a procedure for financial relief of small corporations where stock ownership was identified with management. In this connection it may be noted that the effect of the amendment to Section 366 was to give statutory expression to the findings of this Court in the *U. S. Realty* case. This Court noted that even under the former requirements of Section 366 the "fair and equitable" test could be met by continued management preserving going-concern value of a corporate debtor where the stockholders were the managers of the corporate business.

The enactment of Section 328, which was a companion amendment to the amendment of Section 366, was contrary to the claim of the debtor, more than a mere procedural correction. It was a codification of the law of the *U. S. Realty* case. In particular, it wrote into statutory law the grant of discretion to the District Court to determine whether a Chapter XI proceeding was proper or not. Section 328 states: "The Judge may * * * if he finds that the proceeding should have been brought under Chapter X of this Act, enter an order dismissing the proceedings under this Chapter * * *."

The basic question herein involved, therefore, is whether the District Court did abuse its discretion in directing that the proceedings be transferred from Chapter XI to Chapter X. Only by denying the existence of the criteria by which the propriety of choice between Chapter XI and Chapter X was determined can the debtor assign error to the decision of the District Court and the Court below. If such criteria does exist, then the decision of the District Court was proper in every respect.

The debtor warns this Court that as a result of the decision of the lower Court, considerable confusion now exists with respect to the problem at hand. This is not the case. In the *Transvision* case, the Court below, applying the rules set forth in the *U. S. Realty* case, determined that the District Court properly exercised its discretion in denying transfer to Chapter X. Applying basically the same rules, the Court below in the instant case found that the District Court properly exercised its discretion in directing transfer of the proceedings to Chapter X. Significantly enough the debtor does not assert that the decision of the Court below is in conflict with the *Transvision* case.

We note, from the observation of the Court below, that the debtor is "emphatically not the small corporation in

which the calculated risk of the informal Chapter XI proceedings is warranted." The Court below did criticize in some respect the reasoning of the panel which considered the *Transvision* case but this criticism does not place the *Transvision* decision in conflict with the one presently under consideration. On the contrary, the two decisions read together clearly delineate the rules by which corporate debtors may guide themselves in determining whether Chapter XI or Chapter X provides the proper remedy.

In the language of the concurring opinion of Judge Frank, the *Transvision* case extends the relief afforded by Chapter XI to small corporations basically management owned and having possibly relatively few public stockholders. We believe that notwithstanding the criticism voiced by Judge Clark, the *Transvision* case was intended to stand for nothing else. Certainly nothing in the *Transvision* decision is susceptible to an interpretation favorable to the position of the debtor.

On the other hand, the instant case following the decision of this Court and the prior decisions of the Court below preclude the use of Chapter XI by corporations with substantial numbers of public stockholders and with assets and liabilities numbering well past a million dollars.

In the *Mecca Temple* case, the Court referred to "borderline cases" where there is still no "well defined answer".

In the absence of further amendment to the Bankruptcy Act, such "borderline cases" will continue to perplex the Courts, but there is not involved herein a "borderline case". The facts clearly require a transfer to Chapter X. The interest of several thousand stockholders must be protected. It is not enough to state that the debtor only desires to alter its unsecured obligations which should

inure to the benefit of stockholders. The interest of these stockholders can only be protected by invoking all of the safeguards provided by Chapter X.

CONCLUSION

For the foregoing reasons, petition on writ of certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term 1955

No. 170

IN THE MATTER

OF

Proceedings for an Arrangement Under Chapter XI of the Bankruptcy Act of

GENERAL STORES CORPORATION,

Debtor-Petitioner.

v.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS COMMITTEE and WAGE CLAIMANTS,

Respondents.

Petition of Respondents, Wage Claimants, for Leave to File Their Brief and Brief of the Respondents, Wage Claimants, Supporting the Petition of General Stores Corporation, Debtor-Petitioner, for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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IN THE

Supreme Court of the United States

OCTOBER TERM 1965

No. 170

In the Matter

of

Proceedings for an Arrangement Under Chapter XI of the Bankruptcy Act of

GENERAL STORES CORPORATION,

Debtor-Petitioner.

v.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS COMMITTEE and WAGE CLAIMANTS,

Respondents.

Petition of Respondents, Wage Claimants, for Leave to File Their Brief

The respondents, wage claimants, pray this Honorable Court for leave to serve and file their brief, annexed hereto, as respondents herein, but in support of the debtor-petitioner's petition for a writ of certiorari.

This application is necessitated by the fact that because of circumstances beyond the control of the respondents, wage claimants, the time within which to serve their brief was permitted to lapse unintentionally. Upon discovery

of the default, respondents obtained from the petitioner a stipulation extending their time to file their brief but since such stipulation was filed after the original time to serve the brief had expired, the Clerk of this Court could not accept such stipulation nor extend the time. This default was thus occasioned by an oversight in the office of one of the counsel for the respondents and was not discovered until the original time to file had expired.

During the interval, however, and before discovery of the expiration of the time within which to file the brief, respondents' brief had already been drafted.

Respondents respectfully submit that they have a substantial interest in the question sought to be presented to this Court by the petition for the writ submitted here by the debtor-petitioner.

The respondents are 174 former employees and wage earners of the debtor with claims aggregating approximately $248,000, of which almost $90,000 represent claims entitled to priority under the provisions of Section 64a of the Bankruptcy Act. These wage claimants have already been seriously prejudiced by the order of the Court of Appeals and the District Court, since by reason thereof, they have not yet been paid the amount of their priority claims. Since wage earners are, in a manner of speaking, wards of the Court by virtue of the special preferential treatment accorded them by the Act (to the extent of their priorities), the long delay has definitely injured the respondents and prejudiced their rights.

Respondents respectfully pray for the opportunity to present their side of this controversy to this Honorable Court for a fuller consideration of the claims of all interested parties and the particular merits of the position of these respondents.

Respondents further respectfully submit that the debtor petitioner is not opposed to the granting of respondents' prayer herein for leave to file their brief at this time.

Wherefore, it is respectfully prayed that leave be granted to the respondents, the wage earners, to file the brief annexed hereto to support their position as respondents herein.

Dated, New York, September 22, 1955.

Respectfully submitted,

Max Goldweber,
Counsel for Wage Claimants,
160-16 Jamaica Avenue,
Jamaica, N. Y.

Louis J. Weinshenker,
Of Counsel.

IN THE

Supreme Court of the United States

OCTOBER TERM 1955

No. 170

In the Matter

of

Proceedings for an Arrangement Under Chapter XI of the Bankruptcy Act of

GENERAL STORES CORPORATION,

Debtor-Petitioner.

v.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS COMMITTEE and WAGE CLAIMANTS,

Respondents.

Brief of the Respondents, Wage Claimants, Supporting the Petition of General Stores Corporation, Debtor-Petitioner, for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

Statement

The wage claimants, totaling 174 in number, with total claims aggregating approximately $248,000, of which almost $90,000 represents claims entitled to priority under

the Bankruptcy Act,[1] join in the petition of General Stores Corporation for a writ of certiorari to be issued to review the judgment of the United States Court of Appeals for the Second Circuit, dated April 14, 1955, which affirmed by a divided Court the judgment of the United States District Court for the Southern District of New York, entered on March 7, 1955.

The wage earners having been made respondents herein, were duly served with copies of the petitioner's petition and have thus been made aware of the petitioner's contentions. Since the papers submitted by the petitioner fully set forth the facts and the general discussion of the law, respondents will not burden this Court with a repetition thereof but instead will restrict themselves to a discussion of their particular interests and the effect thereon of the order and judgment appealed from.

The jurisdiction and the questions presented are adequately stated in the debtor's petition.

The pertinent provisions of the statutes involved are set forth in the appendix *infra*, pages 1a to 2a.

Respondents' Reasons for the Granting of the Writ

The 174 wage claimants who are respondents herein lost their employment upon the filing by the debtor of the petition under Chapter XI of the Bankruptcy Act by reason of the fact that the debtor has disposed of the retail stores theretofore operated by it and in which the said respondents were employed. Under the provisions of Chapter XI[2] and Section 64a of the Bankruptcy Act, these wage claimants became entitled to a priority of payment for wages not exceeding $600 each, earned by them within three

1. Sec. 64a(2), Bankruptcy Act, 11 U. S. C. A. 104a(2).

2. Sec. 702, 11 U. S. C. A. 702.

months prior to the filing of the Chapter XI petition, which took place on October 18th, 1954.

Since Section 64a of the Bankruptcy Act is made applicable by the provisions of Section 302 relating to proceedings for arrangement, these respondents, would, in an arrangement proceeding, be entitled to the priority of payment to the extent that such sum does not exceed $600 each and was earned between July 18th, 1954 and October 18th, 1954.

By the order and judgment appealed from, these respondents are completely deprived of such priority since under the provisions of Chapter X[3] of the Bankruptcy Act it is specifically provided that Section 64a of the Bankruptcy Act shall not be applicable to proceedings under Chapter X. It is thus apparent that should the debtor be compelled to resort to Chapter X, these respondents will be seriously prejudiced by the deprivation of the priority of payment to which they are otherwise entitled under Chapter XI or §64a. The wage earners, in addition to having priority claims of approximately $90,000, are also general creditors to the extent of over $150,000.

The order of the District Court (Dimock, J.) is self-executing. It provides for the dismissal of the Chapter XI proceeding unless the debtor files a voluntary petition amending its Chapter XI petition so as to comply with the requirements of Chapter X or unless creditors file an involuntary petition under Chapter X. So far, no creditors have filed an involuntary petition.

The wage earners are thus left at the mercy of the debtor or its other general unsecured creditors. It can be readily conceived that the debtor might find it to its advantage not to file an amended petition under Chapter X for reasons best known to the debtor. In such event, the

3. Sec. 102, Bankruptcy Act, 11 U. S. C. A. 502.

proceedings would be dismissed. This would leave respondents as well as other creditors back where they were prior to the filing of the Chapter XI petition. However, since it has been established that the debtor is in need of some relief which can only be afforded by some provision of the Bankruptcy Act, it might also be within the realm of possibility that the debtor might find it more advantageous to file a voluntary petition under Chapter III. Since the filing date is the measuring stick for the three month period referred to in Section 64a, it is obvious that any subsequently filed petition under any of the provisions of the Bankruptcy Act will completely defeat the rights of the wage earners.

The rights of the wage earners can only be protected by the continuation of the Chapter XI proceeding or by an adjudication of the debtor and the direction that said proceeding be thereafter continued in straight bankruptcy.

Wage earners have been under the special protection of Congress and the courts. The policy of Congress in granting priorities to wage earners has been the subject of judicial comment.

In *Blessing* v. *Blanchard*[4], the Court said:

> "Priority of payment was intended for the benefit of those who are dependent upon their wages, and who, having lost their employment by the bankruptcy, would be in need of such protection."

In the Matter of Paradise Catering Corp.[5], the Court said:

> "Section 64, sub. a (2) was enacted by Congress in order that workmen or servants, persons of menial position and low income, should receive a priority in bankruptcy due to the fact that they as a

4. 225 Fed. 55 (C. C. A. 9th Cir.).

5. 56 F. Supp. 974 (Southern District of New York).

class can ill afford to be classified as general creditors."

In the Matter of Estis[6] the Court said:

> "The intention of Congress was plainly to give special protection to a class of wage earners who generally have no substantial savings or reserves to fall back on in case of adversity and therefore cannot afford to lose."

In the Matter of Lawsam Electric Co., Inc.[7], Judge Learned Hand said:

> "The statute was intended to favor those who could not be expected to know anything of the credit of their employer but must accept a job as it comes, to whom the personal factor in their employment is not a practicable consideration."

It is apparent that the provisions granting priority to wage earners are the result of considerations of social policy. The courts should, therefore, in the ultimate determination of the rights of the parties, give special consideration to the Congressional policies intended by the statutory enactment. It is also important to consider the impact of the order and judgment appealed from. 174 separate and distinct family entities are affected directly and adversely by the decision. These wage earners have a vital and important stake in the affairs of General Stores Corporation. They represent a large segment of the creditors of the debtor and have already been seriously prejudiced by reason of the long delay which has ensued since the filing of the Chapter XI proceeding in the District Court on October 18th, 1954. Normally, the Arrangement

6. 67 F. Supp. 570 (District Court, New York).

7. 300 Fed. 736.

with creditors which was near consummation would have been completed by this time and the wage earners would have been paid the amount of their priorities and such amount on their general claims as the debtor might eventually have paid to compose such claims, but for the decision of the District Judge.

Since, actually, the rights of stockholders are not affected by the Chapter XI proceeding and since the debtor seeks only to compose its claims with its unsecured creditors, it is respectfully submitted that the refusal of Judge Dimock and the Court of Appeals to consider the best interests of the wage claimants, as well as the interests of other general unsecured creditors, constituted an abuse of discretion.

It is without question established from past experience that a proceeding under Chapter X for the reorganization of this company, is bound to take a considerable length of time, much much more than the proceeding under Chapter XI. During all of this time, these wage earners, many of whom spent a lifetime in the employ of the debtor, would be compelled to wait for the mere pittance which should now be theirs upon the severance of their employment.

District Judge Galston, who sat in the Court of Appeals below on the appeal from Judge Dimock's judgment, pointed out this fact very cogently in his dissenting opinion. He said:

> "The wage earners who fall among the unsecured creditors, and who are eager to have prompt payment, certainly will suffer delay if proceedings are had under Chapter 10."

To summarize the position of the respondent wage earners, it is respectfully pointed out:

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8. Petitioner's appendix, p. 7a.

1. The Chapter XI petition was filed on October 18th, 1954.

2. Each wage claimant is entitled to priority for wages earned by him between July 18th, 1954 and October 18th, 1954, not exceeding $600[9].

3. Under the order of Judge Dimock, this priority will be lost to the respondents if the debtor amends its petition to comply with the provisions of Chapter X.

4. If the debtor fails to amend, the original Chapter XI petition will be dismissed. Thereupon, the priority of payment granted to the respondents will be lost, not to be restored, even if a new petition is filed subsequently under any Chapter of the Act, since such filing will postdate by more than three months the period during which the wages were earned.

CONCLUSION

For the foregoing reasons, for the reasons set forth in the debtor's petition, and in the interest of those most seriously affected by the judgment and order appealed from, the writ should be granted.

Respectfully submitted,

MAX GOLDWEBER,
Attorney for Respondent, Wage Earners,
160-16 Jamaica Avenue,
Jamaica, New York.

LOUIS J. WEINSHENKER,
Of Counsel.

September 22, 1955.

---

9. It is not intended to convey the impression that each of the wage claimants is entitled to the sum of $600. A number of them have priority claims which are less than $600.

APPENDIX

Statutes

Pertinent provisions of the Bankruptcy Act as referred to in the brief are as follows:

Section 64a (2), 11 U. S. C. A. 104a (2) reads:

> "Sec. 64. Debts Which Have Priority. a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; * * *"

Section 302 of the Bankruptcy Act, 11 U. S. C. A. 702 reads:

> "Sec. 302. The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, apply in proceedings under this chapter. For the purposes of such application, provisions relating to 'bankrupts' shall be deemed to relate also to 'debtors', and 'bankruptcy proceedings' or 'proceedings in bankruptcy' shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 322 of this Act, and the date of adjudication

shall be taken to be the date of the filing of the petition under section 321 or 322 of this Act except where an adjudication had previously been entered."

Section 402 of the Bankruptcy Act, 11 U. S. C. A. 502 reads:

"Sec. 102. The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter; Provided, however, That section 23, subdivisions h and n of section 57, section 64, and subdivision f of section 70, shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters I to VII, inclusive. For the purposes of such application, provisions relating to 'bankrupts' shall be deemed to relate also to 'debtors', and 'bankruptcy proceedings' or 'proceedings in bankruptcy' shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 128 of this Act, and the date of adjudication shall be taken to be the date of approval of a petition filed under section 127 or 128 of this Act except where an adjudication had previously been entered."

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 170

GENERAL STORES CORPORATION,

Petitioner,

vs.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS' COMMITTEE AND WAGE CLAIMANTS,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS, WAGE CLAIMANTS

Max Goldwasser, Attorney for Respondents, Wage Claimants, 160-16 Jamaica Avenue, Jamaica, New York

Louis J. Weinshenker,

Of Counsel.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 170

GENERAL STORES CORPORATION,

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MAX SHILENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS' COMMITTEE and WAGE CLAIMANTS,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS, WAGE CLAIMANTS

Statement

The wage claimants join with the petitioner, GENERAL STORES CORPORATION, in seeking reversal by this court of the judgment of the Court of Appeals for the 2nd Circuit which affirmed by a divided court (2 to 1 with three separate opinions) the judgment of the United States District Court for the Southern District of New York, in proceedings for an arrangement under Chapter XI of the Bankruptcy Act, which judgment dismissed the arrangement proceedings under Chapter XI unless the petition is amended to comply with the provisions of Chapter X of the Bankruptcy Act.

The respondents support the position of the petitioner because their interests as wage claimants are seriously affected by the judgments below. The wage claimants totaling 174 in number, with total claims aggregating approximately $248,000*, of which almost $90,000 represents claims entitled to priority under the Bankruptcy Act,** respectfully submit to this court that affirmance of the judgments below will deprive them of their priorities of some $90,000 and thus they stand to suffer serious hurt.

POINT I

The wage claimants whose priorities will be destroyed by the transfer of the proceedings to reorganization under Chapter X are substantially and materially affected by the judgments.

The 174 wage claimants, who are respondents herein, lost their employment upon the filing by the debtor of the petition under Chapter XI of the Bankruptcy Act by reason of the fact that the debtor has disposed of the retail stores theretofore operated by it and in which the said respondents were employed. Under the provisions of Chapter XI*** and Section 64a of the Bankruptcy Act, these wage claimants became entitled to a priority of payment for wages not exceeding $600 each, earned by them within three months prior to the filing of the Chapter XI petition, which took place on October 18th, 1954.

Under the provisions of Section 64a which is made applicable by the provisions of Section 302 of the Bank-

* Petition of wage claimants filed in application for a writ of certiorari in this case.

** Section 64a, (2) Bankruptcy Act, 11 U.S.C.A. 104a (2).

*** Sec. 302 Bankruptcy Act, 11 U.S.C.A. 702

ruptcy Act relating to arrangement proceedings, each of the wage earners who had earned any wages between July 18th, 1954 and October 18th, 1954 is entitled to a priority of payment to the extent that such wages do not exceed $600 each.

By the order and judgment appealed from, these respondents are completely deprived of such priority since under the provisions of Chapter X* it is specifically provided that Section 64a of the Bankruptcy Act shall not be applicable to proceedings under Chapter X. It is thus apparent that should the debtor be compelled to resort to Chapter X, these respondents will be seriously prejudiced by the deprivation of the priority of payment to which they are otherwise entitled under Chapter XI or Sec. 64a. The wage earners, in addition to having priority claims of approximately $90,000, are also general creditors to the extent of over $150,000.

The order of the District Court (Dimock, *J.*) is self-executing. It provides for the dismissal of the Chapter XI proceeding unless the debtor files a voluntary petition amending its Chapter XI petition so as to comply with the requirements of Chapter X or unless creditors file an involuntary petition under Chapter X. So far, no creditors have filed an involuntary petition.

The wage earners are thus left at the mercy of the debtor or its other general unsecured creditors. A failure to comply with Chapter X would result in a dismissal of the proceeding. Subsequent proceedings instituted by filing a new petition either in straight bankruptcy or for any other relief would wipe out the priorities since the

* Sec. 102, Bankruptcy Act; 11 U.S.C.A. 502.

original filing date is a measuring stick for the three month period referred to in Section 64a.

The rights of the wage earners can only be protected by the continuation of the Chapter XI proceeding or by an adjudication of the debtor and the direction that said proceeding be thereafter continued in straight bankruptcy.

Wage earners have been under the special protection of Congress and the courts. The policy of Congress in granting priorities to wage earners has been the subject of judicial comment.

In *Blessing* v. *Blanchard*,* the Court said:

> "Priority of payment was intended for the benefit of those who are dependent upon their wages, and who, having lost their employment by the bankruptcy, would be in need of such protection."

In the Matter of Paradise Catering Corp.,** the Court said:

> "Section 64, sub. a (2) was enacted by Congress in order that workmen or servants, persons of menial position and low income, should receive a priority in bankruptcy due to the fact that they as a class can ill afford to be classified as general creditors."

In the Matter of Estey,*** the Court said:

> "The intention of Congress was plainly to give special protection to a class of wage earners who generally have no substantial savings or reserves to fall back on in case of adversity and therefore cannot afford to lose."

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* 223 Fed. 35 (C.C.A. 9th Cir.)

** 36 F. Supp. 974 (Southern District of New York).

*** 6 F. Supp. 570 (District Court, New York).

In the Matter of Laicsam Electric Co. Inc.,* Judge LEARNED HAND said:

> "The statute was intended to favor those who could not be expected to know anything of the credit of their employer but must accept a job as it comes, to whom the personal factor in their employment is not a practicable consideration."

It is apparent that the provisions granting priority to wage earners are the result of considerations of social policy. The courts should, therefore, in the ultimate determination of the rights of the parties, give special consideration to the Congressional policies intended by the statutory enactment. It is also important to consider the impact of the order and judgment appealed from. 174 separate and distinct family entities are affected directly and adversely by the decision. These wage earners have a vital and important stake in the affairs of General Stores Corporation. They represent a large segment of the creditors of the debtor and have already been seriously prejudiced by reason of the long delay which has ensued since the filing of the Chapter XI proceeding in the District Court on October 18th, 1954. Normally, the arrangement with creditors which was near conclusion would have been completed by this time and the wage earners would have been paid the amount of their priorities and such amount on their general claims as the debtor might eventually have paid to compose such claims, but for the decision of the District Judge.

Since, actually, the rights of stockholders are not affected by the Chapter XI proceeding and as the debtor seeks only to compose its claims with its unsecured creditors, it is respectfully submitted that the refusal of Judge DIMOCK and the Court of Appeals to consider the

* 300 Fed. 736.

best interests of the wage claimants, as well as the interests of other general unsecured creditors, constituted an abuse of discretion.

It is without question established from past experience, that a proceeding under Chapter X for the reorganization of this company, is bound to take a considerable length of time, much much more than the proceeding under Chapter XI. During all of this time, these wage earners, many of whom spent a lifetime in the employ of the debtor, would be compelled to wait for the mere pittance which should now be theirs upon the severance of their employment.

District Judge Gaston, who sat in the Court of Appeals below on the appeal from Judge Damock's judgment, pointed out this fact very cogently in his dissenting opinion*. He said:

> "The wage earners who fall among the unsecured creditors, and who are eager to have prompt payment, certainly will suffer delay if proceedings are had under Chapter 10."

To summarize the position of the respondent wage earners, it is respectfully pointed out:

1. The Chapter XI petition was filed on October 18, 1954.

2. Each wage claimant is entitled to priority for wages earned by him between July 18th, 1954 and October 18th, 1954, not exceeding $600**.

3. Under the order of Judge Damock, this priority will be lost to the respondents if the debtor amends its petition to comply with the provisions of Chapter X.

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* 222 F.2.234

** It is not intended to convey the impression that each of the wage claimants is entitled to the sum of $600. A number of them have priority claims which are less than $600.

4. If the debtor fails to amend, the original Chapter XI petition will be dismissed. Thereupon, the priority of payment granted to the respondents will be lost, not to be restored, even if a new petition is filed subsequently under any Chapter of the Act, since such filing will post date by more than three months the period during which the wages were earned.

CONCLUSION

For the foregoing reasons and in the interest of those most seriously affected, the judgment and order appealed from, should be reversed.

Respectfully submitted,

MAX GOLDWEBER, Attorney for Respondents, Wage Claimants, 160-16 Jamaica Avenue, Jamaica, New York.

LOUIS J. WEINSTEIN,
Of Counsel.

December 19, 1955.

APPENDIX

Statutes

Pertinent provisions of the Bankruptcy Act as referred to in the brief are as follows:

Section 64a (2), 11 U. S. C. A. 104a (2) reads:

> "Sec. 64. Debts Which Have Priority. a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; * * *"

Section 302 of the Bankruptcy Act, 11 U. S. C. A. 702, reads:

> "Sec. 302. The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, apply in proceedings under this chapter. For the purposes of such application, provisions relating to 'bankrupts' shall be deemed to relate also to 'debtors', and 'bankruptcy proceedings' or 'proceedings in bankruptcy' shall be deemed to include proceedings under this chapter. For the purposes of such application, the date of the filing of the petition in bankruptcy shall be taken to be the date of the

filing of an original petition under section 322 of this Act, and the date of adjudication shall be taken to be the date of the filing of the petition under section 321 or 322 of this Act except where an adjudication had previously been entered."

Section 102 of the Bankruptcy Act, 11 U. S. C. A. 502 reads:

"Sec. 102. The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: Provided, however, That section 23, subdivisions b and n of section 57, section 64, and subdivision f of section 70, shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters I to VII, inclusive. For the purposes of such application, provisions relating to 'bankrupts' shall be deemed to relate also to 'debtors', and 'bankruptcy proceedings' or 'proceedings in bankruptcy' shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 128 of this Act, and the date of adjudication shall be taken to be the date of approval of a petition filed under section 127 or 128 of this Act except where an adjudication had previously been entered."

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No. 170

In the Supreme Court of the United States

October Term, 1935

German Evans Corporation, Petitioner

v.

Max Eastwood, Secretary and Engineer Commissioner, Chesapeake Conservation and Water Claimants

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENTS AND CROSS-PETITIONER

[illegible]
Special Counsel,
Department of Justice, Washington, D. C.

[illegible]

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In the Supreme Court of the United States

OCTOBER TERM 1955

No. 170

GENERAL STORES CORPORATION, PETITIONER

v.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS' COMMITTEE AND WAGE CLAIMANTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

OPINIONS BELOW

The opinion of the District Court (R. 6a–11a) is reported at 129 F. Supp. 801. The majority and dissenting opinions in the Court of Appeals (R. 86a–92a) are reported at 222 F. 2d 231.

JURISDICTION

The judgment of the Court of Appeals was entered on April 14, 1955 (R. 93a). The petition for a writ of certiorari was filed on June 22,

1955, and was granted on October 10, 1955 (R. 93a). The jurisdiction of this Court rests upon 28 U. S. C. 1254 (1).

QUESTION PRESENTED

Whether a corporate debtor with assets of about $5,000,000, approximately 7,000 stockholders, and over 2,000,000 shares of common stock actively traded on a national securities exchange, may utilize the arrangement procedure of Chapter XI of the Bankruptcy Act or whether it must use the corporate reorganization procedure of Chapter X.

STATUTE INVOLVED

Chapters X and XI of the Bankruptcy Act, 52 Stat. 883 and 905, 66 Stat. 431 (11 U. S. C. 501 *et seq.* and 701 *et seq.*) are involved in this proceeding substantially in their entirety. The provisions of Sections 328 and 366, which are directly involved, are set forth at pages 49 and 50 of petitioner's brief. A comparative summary of the pertinent provisions of both chapters is set forth in Appendix A, *infra* pp. 49–51.

STATEMENT

The petitioner, General Stores Corporation, which instituted this proceeding as a petitioning debtor under Chapter XI of the Bankruptcy Act, is a New York corporation organized in 1915. Petitioner was formerly known as D. A. Schulte, Inc.; it assumed its present name in 1954 (R. 7a,

12a, 31a). From its inception, and until recently, it was engaged in the business of operating chain stores for the sale of tobacco and accessory products, principally in the northeastern states (R. 7a).

The debtor has outstanding 2,232,422 shares of $1 par value common stock, which is listed and actively traded on the American Stock Exchange. This stock is held by over 7,000 widely scattered shareholders. (R. 7a, 30a.)

In the schedules attached to its petition petitioner listed assets, per books, of $4,921,421; of which about $4,000,000 represented investments in the stocks of Stineway Drug Company and Ford Hopkins Company—two wholly-owned subsidiaries—which stocks petitioner recently acquired under circumstances and upon terms hereinafter described (R. 34a). Its liabilities were listed at $3,900,410, which included secured notes in the amount of $2,065,000 and unsecured notes for $1,310,000. See pp. 6–7, *infra*. Its obligations to trade creditors amounted to $524,970. (R. 35a, 41a.)

Petitioner's financial difficulties are not of recent origin. They relate back at least to 1936 when it filed a petition for reorganization under former Section 77B of the Bankruptcy Act. It emerged from reorganization in 1940. (R. 7a, 21a, 30a.) Petitioner enjoyed a few profitable years during the war boom. Then a post-war

decline in volume and prices, coupled with rising costs, resulted in substantial losses, and, as the district court observed, "[a]ttempts at modernization of existing units failed materially to stem continuing losses." (R. 7a.) During the four years and five months ended March 31, 1953, the debtor sustained aggregate losses exceeding $2,700,000. In the next twelve months aggregate losses continued to increase and reached over $4,200,000. (R. 32a.)

In the post-war years, a substantial amount of equity capital was raised by the sale of additional common stock. In July 1951, nine investors purchased 400,000 shares of stock at $1.50 per share, or at a total price of $600,000. These purchasers also received options to purchase 332,157 additional shares, one-half of this amount at $1.60 per share and the balance at $1.70 per share. (R. 30a.) Following these transactions, a new management was installed with the intention of using the new money for converting existing stores into candy or food and drink establishments. When further study indicated that conversion would be too costly, the program was abandoned and the proceeds of the stock sale were used for general corporate purposes. (R. 8a, 31a, 32a.)

In 1952, at the insistence of the option holders, virtually all of the shares subject to the 1951 transactions were registered with the Securities

and Exchange Commission under the Securities Act of 1933 for the purpose of enabling these holders to make a secondary offering of the stock to the public. As of July 21, 1954, 404,769 of these shares were thus sold. (R. 31a.) In 1954, an additional 178,500 shares were sold by petitioner at $1.375 per share, and the proceeds, in the amount of $245,438, were applied to the purchase of the stock of Ford Hopkins Company, as further shown below. (R. 9a, 31a.)

Having concluded that conversion and modernization of its facilities were not feasible, the management turned to other alternatives for profitable operations. It was decided to liquidate the existing specialty stores and to have the debtor become a holding company by acquiring all the outstanding stocks of Stineway Drug Company and Ford Hopkins Company. The Stineway stock was acquired in August 1953, the Ford Hopkins stock early in 1954. (R. 8a–9a.) Stineway operates a chain of 23 retail drug stores in the Chicago area; it also sells merchandise to 12 independent stores in that area known as the Stineway System Stores. Ford Hopkins operates a chain of 48 drug stores and three restaurants in the Midwest. A subsidiary of Ford Hopkins, Sargent's Drug Store, operates five stores in the Chicago area and supplies standard cosmetic items to about 700 grocery chain stores. (R. 8a, 9a, 32a, 33a.)

The Stineway stock was acquired at a cost of $1,220,320, for the payment of which petitioner ultimately borrowed from Stineway $870,000. As of the date when the Chapter XI petition here involved was filed, petitioner was indebted to Stineway in the amount of $1,310,000, the balance of $440,000 representing an additional loan to help make the down payment on the purchase by petitioner of the Ford Hopkins stock. (R. 8a, 32a.) This total indebtedness to Stineway was represented by two non-interest bearing notes, one for $225,000 payable December 15, 1954, and the other for $1,085,000 payable June 1, 1964 (R. 33a–34a). None of these loans has been paid to date. It may be noted that, exclusive of the latter note, the debtor has estimated the Stineway net worth at $500,000 (R. 34a). The $1,310,000 in loans to the debtor thus appears to represent a major portion of Stineway's net worth.

The purchase price of the Ford Hopkins stock was $2,800,000, payable $735,000 upon consummation, the balance in minimum amounts of $200,000 per year, at 4% interest (R. 9a, 48a). The down payment of $735,000 was derived from (1) the proceeds of the sale of 178,500 shares of common stock in May 1954: $245,438; (2) the proceeds of loans, including one from the debtor's president: $55,000; and (3) the proceeds of a loan from Stineway: $440,000. Stineway derived this cash from the sale of warehouse inventory to Ford

Hopkins, which in turn was required to borrow $400,000 from a bank in order to pay for the inventory. (R. 9a, 33a.)

To secure the balance of the purchase price, $2,065,000, the debtor transferred the following collateral to a trustee: (1) all of the capital stock of Ford Hopkins and Stineway; (2) dividends payable upon Ford Hopkins and Stineway stock; (3) life insurance policies aggregating $1,700,000 upon the life of the trustee (one of the sellers); and (4) petitioner's rights to commissions payable to it by Ford Hopkins and Stineway under service contracts based generally upon 1% of the net sales of Ford Hopkins and Stineway (R. 9a; 33a).

To complete the process of conversion, petitioner commenced to liquidate its own stores (R. 8a). Although it was operating 146 of such stores on July 21, 1954, there remained only 76 at the time petitioner filed its petition for relief under Chapter XI of the Bankruptcy Act on October 18, 1954 (R. 32a, 42a). During the Chapter XI proceeding, it disposed of all its remaining stores. These dispositions were facilitated through court-approved rejection of leases pursuant to Section 313 (1) of Chapter XI, and as a consequence have created landlords' claims under Section 353 of that Chapter. (R. 45a.)

In its petition under Chapter XI, filed on October 18, 1954, a few months after the acquisition

of the Ford Hopkins stock, petitioner proposed an arrangement extending its unsecured obligations and providing for payment of 20% on confirmation and 20% annually for four years thereafter (R. 12a–14a). The notice to creditors listed, besides the obligation to Steinway, unsecured claims of about $525,000 (R. 41a). This is exclusive of landlords' claims resulting from the subsequent rejection of leases in the course of the Chapter XI proceedings.

The District Court granted the motions of the Commission and of a stockholder to dismiss the Chapter XI proceeding unless the petitions were amended to comply with the requirements of a petition under Chapter X (R. 3a–11a). The Court of Appeals, with District Judge Galston dissenting, affirmed (R. 86a–93a).

SUMMARY OF ARGUMENT

1. This case is controlled by *Securities and Exchange Commission* v. *United States Realty & Improvement Company*, 310 U. S. 434, where a corporation with publicly held securities was not permitted to utilize the procedure for an arrangement under Chapter XI of the Bankruptcy Act because it was held that adequate relief could be obtained only through Chapter X of the Act. The "'relief * * * available under Chapter X" was determined to be "more consonant" with "considerations growing out of the public policy of the Act found both in its legislative history and

in an analysis of its terms." *Id.* at 448. As there pointed out, Chapter X was intended to provide the investing public with numerous protections against the evils and abuses that had pervaded earlier reorganizations, protections absent from Chapter XI and unnecessary for the "small * * * corporations with few stockholders" for which Chapter XI is adapted. *Id.* at 447.

As in the *Realty* case, the debtor here has public security holders entitled to the protections of Chapter X. Moreover, this debtor has a history of financial difficulties, has suffered large and mounting losses in recent years, and came to the bankruptcy court while it was only part way through a program attempting to recast its entire business. In these circumstances, only the thorough procedures of Chapter X are adequate for dealing effectively with the readjustment of all the financial affairs of the debtor, which operates through newly purchased subsidiaries a substantial business enterprise in a field new to it.

2. Petitioner's argument that it is the plan advanced by the debtor rather than the character of the debtor that controls is wholly contrary to the *Realty* decision, which repeatedly emphasized the type of debtor involved rather than the relief sought. This Court made clear that the "adequate relief" referred to in the Bankruptcy Act as a basis for choosing between Chapter X and Chapter XI is not synonymous with the relief

sought by the management and acceptable to trade creditors, as petitioner claims, but must be determined "in the light of its effect on all the public and private interests concerned. * * *" *Id.* at 455. Moreover, the determination as to the comparative adequacy of the relief afforded by the two chapters is to be made at the outset of the proceeding. Under Chapter X, however, there could be no plan in existence at that time, so that the comparison cannot be made upon the basis of specific plans. This fact demonstrates sharply the fallacy of the argument that the nature of the plan proposed should be decisive in choosing between Chapter X and Chapter XI.

3. The 1952 amendments to the Bankruptcy Act reveal Congressional adoption of the rule in the *Realty* case and acceptance of the proposition that Chapter XI is not to be used for corporations with numerous investors. The removal of the "fair and equitable" requirement for a Chapter XI plan, upon which petitioner relies, is shown by the legislative history to have been intended only for individual debtors or corporations "where the stock ownership is substantially identical with management." Simultaneously, Congress enacted a provision setting up machinery for dismissal of a proceeding improperly brought under Chapter XI or its transfer to Chapter X and authorizing the Securities and Exchange Commission to apply for such relief. The legis-

lative history states that this provision "codifies the law" of the *Realty* case. Moreover, the 1952 amendments were considered "noncontroversial in character" and clearly could not have intended the far-reaching results for which petitioner contends.

4. The fact that the public investors with whom the Court was concerned in the *Realty* case were creditors rather than stockholders constitutes no basis for distinction. The numerous protections for public investors in Chapter X are specifically made available to "stockholders" as well as to "creditors." Petitioner contends that, by reason of the removal of the "fair and equitable" provision from Chapter XI, stockholders may conceivably enjoy benefits *vis-à-vis* creditors in Chapter XI which are unavailable in Chapter X. But Congress could not have intended this result to depend upon the management's choice of the statutory reorganization technique to be followed. And Congress was evidently satisfied that the significant benefits provided by Chapter X for the numerous investors of corporations like the U. S. Realty Co. and the debtor in this case would outweigh any possible benefits they might derive from Chapter XI.

Thus, even assuming that in a particular Chapter XI proceeding trade creditors might agree to take less than the amount of their claims in order to have the debtor continue in business, such con-

finance in business might not be in the interests of the debtor's stockholders since it could lead to the dissipation of an existing equity for stockholders. Under Chapter XI public stockholders would have the advice only of the debtor's management, rather than the benefit of advice of an independent trustee based upon an objective investigation as to whether the business should be continued and the nature of any reorganization required. Nor would they under Chapter XI have the benefit of possible causes of action against existing or former management which an independent trustee might uncover. Moreover, under Chapter X, in appropriate circumstances, individual trade creditors could agree to take less than the full amount on their claims, since the considerations affecting the absolute priority rule (required by the "fair and equitable" standard) might be different with respect to such creditors from those involving public holders of debt obligations.

ARGUMENT

THE COURTS BELOW PROPERLY HELD THAT THE DEBTOR, A SIZABLE CORPORATION, OPERATING THROUGH SUBSIDIARIES AND HAVING NUMEROUS PUBLIC STOCKHOLDERS, MAY NOT UTILIZE THE ARRANGEMENT PROCEDURE OF CHAPTER XI OF THE BANKRUPTCY ACT IN AN ATTEMPT TO RELIEVE ITS SERIOUS BASIC DIFFICULTIES, BUT MAY USE ONLY CHAPTER X, WHICH PERMITS A THOROUGH REORGANIZATION AND CONTAINS SAFEGUARDS FOR PUBLIC INVESTORS

Following the guideposts furnished by this Court in *Securities and Exchange Commission* v. *United States Realty & Improvement Company*, 310 U. S. 434, the courts below have held that the petitioner may not utilize Chapter XI of the Bankruptcy Act, but that the "widespread stockholder interest in a corporation with such a shaky financial history as this one" (R. 88a) requires any rehabilitation under the Bankruptcy Act to be conducted solely through Chapter X, which contains appropriate safeguards for public investors. Petitioner first attempts to distinguish this case from the *Realty* case. Alternatively, it seeks reversal of the courts below on the basis of certain amendments to Chapter XI made in 1952, which petitioner reads as overruling the *Realty* case or greatly limiting its application. We shall show that the courts below properly applied the principles of the *Realty* decision and that petitioner's arguments to the contrary are in large part the

very arguments which were there rejected by this Court. We shall also show that the 1952 legislation neither overruled, nor limited *U. S. Realty*; but was premised on full acceptance of that decision.

I. THE CONSIDERATIONS WHICH WERE CONTROLLING IN THE *REALTY* CASE ARE EQUALLY CONTROLLING HERE

In the *Realty* case this Court reversed the determination of two lower courts that an arrangement under Chapter XI of the Bankruptcy Act might be utilized by the corporation there involved, which, like the debtor here, had numerous public investors. The debtor in that case had outstanding 900,000 shares of stock listed on the New York Stock Exchange and held by some 7,000 stockholders. It had assets of a stated value of approximately $7,000,000. It had direct liabilities of about $5,000,000, approximately half of which consisted of two series of publicly-held secured debentures; and it was a guarantor of defaulted sinking fund certificates issued by a wholly-owned subsidiary in the amount of approximately $3,700,000 and held by some 900 persons. The plan of arrangement contemplated a modification of the terms of the guarantee. This Court pointed out that the question whether Chapter X or XI was available turned "on considerations growing out of the public policy of the Act found both in its legislative history and in an

analysis of its terms", and hold it to be reversible error for a proceeding to be entertained under Chapter XI "when relief is available under Chapter X, which is adequate and more consonant with that policy" (310 U. S. at 448).

Equity receiverships, the Court pointed out, had been characterized by "lack of knowledge and control by the court of the conditions attending formulation of reorganization plans, the inadequate protection of widely scattered security holders, the frequent adoption of plans which favored management at the expense of other interests, and which afforded the corporation only temporary respite from financial collapse" (*id.* at 448). These conditions were intended to be eliminated in Chapter X, which operated on "the basic assumption * * * that the investing public dissociated from control or active participation in the management, needs impartial and expert administrative assistance in the ascertainment of facts, in the detection of fraud, and in the understanding of complex financial problems" (*id.* at 448–449, footnote 6).

The legislative history of the Chandler Act, by which Chapters X and XI came into existence, makes clear the wholly different rehabilitation problems presented by a corporation having publicly-held securities from those presented by an

individual or a closely held corporation.[1] The differences arise because public investors normally tend to be widely scattered and unable to attend meetings; their individual investments are often small and they may have little financial experience. Since they are not directly connected with the management of the enterprise, they may know comparatively little about it. By contrast, in a corporation without public investors the stockholders or persons closely allied to them normally constitute the management. Creditors are usually banks or trade creditors; they are familiar with the debtor's condition, management and prospects; they are able to act as a unit through trade and credit associations or through counsel or informal committees; and they may expect, moreover, to profit through future dealings with the debtor. It is for this latter sort of business that

[1] See, for example, the Report of a Special Senate Committee to Investigate Receivership and Bankruptcy Proceedings (S. Doc. No. 268, 74th Cong., 2d sess.), which stated (p. 13):

"There is * * * a clear distinction to be observed between a corporation the stock of which is privately owned by a small number of persons and which is indebted to trade creditors, and a corporation the securities of which are in the hands of the public. The problems of the former are not shared by the latter; the problems of the latter have no concern with the former."

Legislative and other materials detailing the problems are listed in the *Realty* case, 310 U. S. at 449, footnote 7.

Chapter XI was intended, since in such situations the safeguards of Chapter X may not be essential.

These safeguards were summarized in the *Realty* case as follows (310 U. S. at 449–450):

> Except where the liabilities are less than $250,000, Chapter X requires the appointment of a disinterested trustee, §§ 156–158, and a thorough examination and study by the trustee of the debtor's financial problems and management, § 167 (3) (5). The trustee is required to report the result of his study, to send the report to all security holders with notice to submit to him proposals for a plan of reorganization, § 167 (5) (6). He then formulates a plan or reports the reasons why a plan cannot be formulated, § 169. By § 176 consent to a plan in advance of its initial approval by

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[3] As pointed out in the *Realty* case, 310 U. S. at 447, Chapter XI was devised for "composition of debts of small individual business and corporations with few stockholders." It "was sponsored by the National Association of Credit Men and other groups of creditors' representatives expert in bankruptcy." *Id.* at 450, footnote 8. See, *e. g.*, the statement of a representative of the National Bankruptcy Conference at the hearing before the House Committee on the Judiciary (House Hearings on H. R. 6439, 75th Cong., 1st sess. (1937), p. 45):

"Subsection I [Chapter XI] is no different from the present section 12 which has been with us for year[s], except that it allows wider rights. A man goes in, who has a little business as a druggist, and wants to make a composition with his creditors."

The cases for which Chapter XI was intended were also referred to as "'hot-dog stand' cases." House Hearings on H. R. 6439, 75th Cong., 1st sess. (1937), p. 175.

the judge is void unless procured with his consent. A large measure of control is given to the court over the reorganization and of committees of security holders and their compensation, §§ 163, 165, 209, 212, 241–243.

If the judge finds the plan presented worthy of consideration he may refer it to the Commission for report and must do so where the liabilities of the debtor, as in the present case, exceed $3,000,000, § 172. When the plan is submitted to creditors after approval by the judge it is accompanied by the report of the Commission and the opinion of the judge approving the plan, § 175. The Commission with the approval of the court is authorized to participate generally in the proceedings as a party, and it is its duty to do so upon request of the court, § 208.

In contrast, this Court pointed out (*id.* at 450–451):

No comparable safeguards are found in Chapter XI. Every phase of the procedure bearing on the administration of the estate and the development of the arrangement is under the control of the debtor. The process of formulating an arrangement and the solicitation of consent of creditors, sacrifices to speed and economy every safeguard, in the interest of thoroughness and disinterestedness, provided in Chapter X. The debtor is generally permitted to stay in possession and operate the

> business under the supervision of the court, § 342, and a trustee is provided for only in the case where a trustee in bankruptcy has previously been appointed and is in possession, or if "necessary" a receiver may be appointed. § 332. The debtor proposes the arrangement, §§ 306 (1), 323, 357, and the only opportunity afforded the creditors in respect to the proposed plan is to accept or reject it as submitted by the debtor. * * *
>
> * * * The arrangement may be consummated at the conclusion of a single creditor's meeting. The court in passing upon the arrangement, is without the benefit of investigation and study by the trustee or Commission, which Congress has required in reorganization proceedings under Chapter X; and is then faced with the fact that a majority of the creditors have already accepted the plan.[3]

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[3] A detailed chart contrasting the provisions of Chapters X and XI is set forth in Appendix A to this brief, *infra*, pp. 49–51.

Similar provisions under both chapters exempt securities issued pursuant to a plan from the registration requirements of Section 5 of the Securities Act of 1933, 15 U. S. C. 77e. See Section 264a (2) under Chapter X and Section 393a (2) under Chapter XI. An effective substitute for such registration is provided under Chapter X by various of the provisions referred to in the *Realty* case, such as preliminary judicial approval of a plan, court control over the information to be disseminated, and the report of the Securities and Exchange Commission on the plan. The lack of comparable controls under Chapter XI is further evidence

We submit that the considerations set forth above, which were controlling in the *Realty* case, should be equally controlling here. As we have seen, the debtor's securities are widely held, and this fact alone would seem sufficient to require a determination that adequate relief is unattainable under Chapter XI. Moreover, the debtor is and has been for many years in serious basic difficulties. It has sustained mounting losses and is today unsoundly financed. Largely with borrowed monies, the proceeds of sale of additional stock to persons close to management (subsequently sold in part to the public), and the syphoning off of cash from purchased companies, the debtor has acquired ownership of two drug chains in a new area. Then, halfway through the program of converting its operations, the debtor found it necessary to invoke the jurisdiction of the bankruptcy court. These facts make it clear that Chapter XI is inappropriate and that the case calls for the more thorough and better safeguarded proceedings provided by Chapter X.

Petitioner seeks to avoid Chapter X, which would afford the bankruptcy court the broadest

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of the Congressional intent to limit the use of that Chapter to small, closely-held corporations, since there is no cogent reason why Congress could have intended that all such controls could be avoided by a corporation issuing such new securities to its public securities holders by the simple expedient of proceeding under Chapter XI.

powers to deal with its problems, even though petitioner, now operating wholly through subsidiaries, may well require an overall reorganization which would deal with the assets of the subsidiaries. Chapter XI contains no machinery to reach that result. As stated in the *Realty* case, 310 U. S. at 452, "a subsidiary of the debtor may be brought into * * * a [Chapter X] proceeding and reorganized with the debtor. § 129." Certainly, a debtor may not have part of its reorganization under Chapter XI and part outside the Act. This was what was proposed in the *Realty* case. To deal effectively with financing problems and the possibility of incompetent or bad management in this extensive corporate enterprise, Chapter X alone provides the necessary investigative and analytical procedures, the necessary powers in the court to effectuate a sound result, and the necessary protections for the interest of the debtor's public investors in the substantial book equity represented by the debtor's assets which are pledged for the debtor's collateral notes. Under these circumstances, as this Court held in the *Realty* case, it would have been contrary to the policy of the Chandler Act for the courts below to have permitted Chapter XI to be utilized by the debtor.

2. PETITIONER ERRS IN ARGUING THAT IT IS THE PLAN RATHER THAN THE CHARACTER OF THE DEBTOR WHICH IS CONTROLLING

In urging that the *Realty* case is not controlling here, the petitioner argues (Br. 11) that the

"essential characteristic of the debtor's petition in this case, as distinguished from the petition in the *U. S. Realty* case is the proposed plan." It assumes that it was the plan involved in the *Realty* case and "not the character of the debtor" which there precluded the use of Chapter XI (Pet. Br. 39).

The essential fallacy in this argument arises from petitioner's interpretation of the meaning of "adequate relief" as used in Sections 130 (7) and 146 and 147 of the Act (see Pet. Br. 16–18, 23–28). This key phrase does not mean, as the petitioner seems to think, merely the steps which the debtor's management desires and which are acceptable to the merchandise and other creditors who would participate in a Chapter XI proceeding. As this Court made clear in the *Realty* case (310 U. S. at 447–448):

> * * * granting the jurisdiction of the court [under Chapter XI], the question remains of the propriety, in the circumstances, of its order retaining jurisdiction, and of the extent of its duty to go forward with the proceeding under Chapter XI in the face of the contention that Chapter X alone affords a remedy adequately protecting the public and private interests involved. The answer turns not on the court's statutory jurisdiction to entertain a proceeding under Chapter XI, but on considerations

> growing out of the public policy of the Act found both in its legislative history and in an analysis of its terms, and of the authority of the court clothed with equity powers and sitting in bankruptcy to give effect to that policy through its power to withhold relief under Chapter XI when relief is available under Chapter X, which is adequate and more consonant with that policy.

Again, this Court stated that "the adequacy of the relief under Chapter XI must be appraised in comparison with that to be had under Chapter X, and in the light of its effect on all the public and private interests concerned including those of the debtor." *Id.* at 455.

All interests must be appraised. For that reason, use of Chapter XI is not rendered proper, as petitioner believes (see Pet. Br. 17, 24–27), by the fact that the commercial creditors here involved may have adequate representation and may not need a report of this Commission. For the debtor's public investors are necessarily concerned when the financial affairs of their corporation have so deteriorated that resort to the rehabilitation provisions of the Bankruptcy Act is necessary. And, as we have seen, pp. 15–18, *supra*, the interests of these public investors require all the procedures of Chapter X. See also, *infra*, pp. 37–46.

Petitioner urges that Chapter XI is not wholly devoid of protective provisions, pointing out that there can be an examination pursuant to Section 21 of the Bankruptcy Act or the appointment of a receiver[4] (Br. 27–28). The *Realty* case shows, however, that these are not adequate substitutes for the full protections afforded public investors by Chapter X, *supra*, pp. 17–19. As this Court stressed in that case, Chapter X was designed by the Congress to assure to public investors the safeguards and protections it determined to be necessary to achieving the satisfactory rehabilitation of a corporation in financial difficulties. It would be

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[4] Section 332 of the Act gives the court power to appoint a receiver "if necessary." See Rostow and Cutler, *Competing Systems of Corporate Reorganization*, 48 Yale Law Journal 1334, 1341 (1939) (footnotes omitted):

"The appointment of a custodian is discouraged. It is provided that upon the application of a party in interest the court may appoint a receiver, if necessary. Presumably the applicant will have to show grounds of necessity comparable to those required under Section 2a (3), governing the appointment of bankruptcy receivers generally. It is significant that Chapter XI, drafted by bankruptcy lawyers, provides for a receiver and not a trustee, for a receiver under the Bankruptcy Act has been an officer of limited authority, with less capacity for initiative than a trustee. The receiver may carry on the business and issue certificates of indebtedness, but he has no functions of inquiry, nor any duties in connection with drafting the arrangement. It is unlikely that receivers under Chapter XI will be appointed as often as trustees under Chapter X. And even where a receiver is appointed, the Act makes no provision for an investigation, a report, or a determination of the economic justification for continuing the business."

anomalous, indeed, if a corporation like the petitioner could escape these legislative safeguards and protective measures by merely proposing a plan limited to an arrangement. One of the reforms accomplished by Chapter X was the adoption of Section 169 of the Act, which provides that the independent trustee rather than the debtor is responsible for the initial submission of a plan. The debtor cannot dictate the form or substance of a Chapter X reorganization, whether commenced voluntarily or involuntarily. It would be wholly inconsistent with the purpose of this reform if by reason of the relief it requests a debtor could choose between Chapter XI and Chapter X. *Cf. Case* v. *Los Angeles Lumber Products Co. Ltd.*, 308 U. S. 106, 129 *et seq.*

That it was the character of the debtor rather than the plan proposed which was determinative of the *Realty* decision is also clear from additional portions of the opinion. References to Chapter X as "adapted to the reorganization of corporations with complicated debt structures and many stockholders" and to Chapter XI as adapted "to composition of debts of small individual business and corporations with few stockholders" (310 U. S. at 447) are wholly contrary to petitioner's view. So also is the observation that denying the propriety of Chapter XI for corporations like the U. S. Realty Co. and the present petitioner left room "for application of that chapter in many

cases where the debtor's financial business and corporate structure differ from respondent's", as in the case of "small individual or corporate business" (310 U. S. at 454).

The conclusion that it is the character of the debtor which is decisive in choosing between Chapter X and Chapter XI derives further support from the fact that the court must determine at the outset of the proceeding which of the two chapters is applicable. In the *Realty* case, it was pointed out (p. 455) that had the debtor proceeded under Chapter X, "the judge would have been compelled upon inquiry to approve its petition on the ground * * * that adequate relief could not be obtained under Chapter XI." That determination would have had to be made without reference to any plan or arrangement, and would necessarily have rested on the character and financial situation of the particular corporation involved.[5] The *Realty* case held that the same approach had to be used where the issue arose in a Chapter XI proceeding.

Reference in the *Realty* opinion to the arrangement actually proposed in the Chapter XI pro-

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[5] The provisions respecting formulation of a plan are contained in Article VII of Chapter X, headed "Proceedings Subsequent to Approval of Petition." See Sections 168–170. The plan is prepared by the trustee (Section 169), who is not appointed until "the approval of a petition" (Section 156). Cf. *In re Julius Roehrs Co.*, 115 F. 2d 723 (C. A. 3).

ceeding, as well as to possible amendments thereto (*id.* at 453), were merely to illustrate the need for the protections for public investors afforded by Chapter X. As a matter of fact, neither in that case nor in the instant case did the plan which was proposed purport to be immutable; indeed, as petitioner states (Br. 4)[6]: "Arrangement plans may be (and they usually are) altered or modified at various stages of a proceeding up to the time of confirmation."

Recognition of this fact is hardly consistent with petitioner's insistence that the initial, admittedly tentative, proposal of the debtor should control the selection of the appropriate chapter. Rather, it reinforces the view that the nature of the debtor, the financial difficulties of which occasion the resort to the Bankruptcy Act, must be determinative.

The facts stressed by petitioner—that it comes within the express definition of a "debtor" in Sections 4 and 306 (3) of the Act and that it has submitted an "arrangement" within the definition of Section 306 (1) (Pet. Br. 17, 38)—were equally present in the *Realty* case, where this Court conceded that the requirements of these sections were met, stating (310 U. S. at 446):

> It is evident that the language of the sections to which we have referred in terms

[6] The *Realty* case refers to "an amended arrangement which is not in the record and the terms of which are not disclosed." 310 U. S. at 453.

> confers on the court jurisdiction of a petition for an arrangement, which the present petition is, filed by a debtor, which the respondent is, in the technical sense that it confers on the court power to make orders in the cause which are not open to collateral attack.

Only the minority of the Court considered this controlling. In quoting statements to that effect from the dissenting opinion (Pet. Br. 35, 40, 41), petitioner appears to be urging this Court to overrule the *Realty* decision. We submit that the considerations requiring the result reached in that case are fully applicable today, and, as pointed out below, that this has been recognized by Congress.

3. THE 1952 AMENDMENTS TO THE BANKRUPTCY ACT ACCEPTED AND CODIFIED THE *REALTY* HOLDING; THEY DID NOT OVERRULE IT OR LIMIT ITS APPLICABILITY

The only changed circumstance to which petitioner points in urging that this Court reverse itself is the 1952 amendatory legislation to the Bankruptcy Act.[7] This legislation, however, as Judge Clark pointed out in the opinion below, wrote into the Bankruptcy Act the "criteria for choice between Chapter XI and Chapter X enunciated" in the *Realty* case (R. 89).

Far from suggesting that the rule of the *Realty* decision was to be changed, the Congress which

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[7] 66 Stat. 420.

wrote the 1952 amendments expressly stated its purpose to codify that rule. Thus, the Report of the House Committee states:[8]

> Section 30 of the bill adds a new section 328 at the end of article IV of chapter XI of the act. In *Securities and Exchange Commission* v. *U. S. Realty & Improvement Co.*, 310 U. S. 434, 42 Am B. R. (N. S.) 602, 60 S. Ct. 1044; 84 L. Ed. 1293 (1940), where a petition was filed under chapter XI by a debtor corporation having hundreds of creditors and thousands of stockholders, it was decided that the court had the duty to dismiss the petition, leaving the corporate debtor to seek relief under chapter X. In that case, the petition under chapter XI was dismissed after the proceeding had been running for many months and a proceeding had to be started anew under chapter X.
>
> Under section 147 of chapter X, a petition improperly filed thereunder, because adequate relief can be obtained by the debtor under chapter XI, may be transferred to chapter XI and thereafter for the purposes of chapter XI, be deemed to have been originally filed thereunder. There is no corresponding provision in chapter XI for a transfer of a chapter XI proceeding, if improperly filed thereunder, to chapter X. The proposed amendment supplies this lack. *It codifies the law of the United*

[8] H. Rep. No. 2320, 82d Cong., 2d sess, p. 19.

> *States Realty & Improvement case, and adopts the procedure of section 147 for transferring the proceeding to chapter X.* [Emphasis added.]

It is clear that this intended codification was not, as petitioner suggests (Br. 15, 39–40), designed merely to give the courts explicit procedural power to dismiss an improper Chapter XI petition or order its transfer to Chapter X. For whatever might be the significance of the new Section 328 standing alone, other aspects of the 1952 amendments leave no room for doubt that Congress accepted and carried forward the substantive principles of the *Realty* case. Thus, although petitioner relies (Br. 13, 22, 35–36) upon the amendment which deleted the requirement that an arrangement under Chapter XI must be "fair and equitable,"[9] the explanation accompanying

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[9] 66 Stat. 433.

The "fair and equitable" requirement, which is contained in Chapter X (Sections 174 and 221 (2) of the Act), was derived from the predecessor statute, Section 77B, and in turn from equity receivership precedents. This Court has held that the requirement embodies the doctrine of absolute priorities, under which a reorganization plan must fully compensate creditors and stockholders in the order of their priorities; that is, seniors must receive the equitable equivalent of the full value of their claims before juniors may participate, and if senior claimants are not compensated in full, juniors may receive nothing unless they make a fresh contribution of capital. *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, 115–119; *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510, 527–529.

this change shows (1) that it was in no sense fashioned for the alteration of the *Realty* rule petitioner seeks, but (2) that it was premised squarely on the assumption that this rule remained desirable and unimpaired. Proceeding on this premise—that the scope of Chapter XI was to remain as limited in the *Realty* case—the House Report stated:[10]

> * * * the fair and equitable rule, as interpreted in *Northern Pacific Railway Co.* v. *Boyd*, 228 U. S. 428, 33 S. Ct. 554, 57 L. Ed. 931 (1913), and *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, 41 Am. B. R. (N. S.) 110, 60 S. Ct. 1, 84 L. Ed. 110 (1939), cannot realistically be applied in a chapter XI * * * proceeding. Where it is so applied, no individual debtor, and under chapter XI, no corporate debtor *where the stock ownership is substantially identical with management could effectuate* an arrangement except by payment of the claims of all creditors in full. [Emphasis added.]

As the Report shows, it was the intent of the Congress to enable closely-held corporations, where there is substantial identity between stock ownership and management, to effectuate an arrangement without meeting the fair and equitable test. And this is, of course, perfectly consistent with

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[10] H. Rep. No. 2320, 82d Cong., 2d sess., p. 21. See also S. Rep. No. 1395, 82d Cong., 2d sess., p. 12.

the view expressed in the *Realty* case that Chapter XI has its appropriate application to (p. 454)

> * * * small individual or corporate business where there are no public or private interests involved requiring protection by the procedure and remedies afforded by Chapter X. In cases where subordinate creditors or the stockholders are the managers of its business, the preservation of going-concern value through their continued management of the business may compensate for reduction of the claims of the prior creditors without alteration of the management's interests, which would otherwise be required by the Boyd case.[11]

It is thus clear that Congress was content to remove the "fair and equitable" test from Chapter XI because it recognized and accepted the rule that cases where there are public investors are excluded from this Chapter.

It is to be noted, moreover, that the 1952 amendments were designed to be "uncontroversial in character" and were described in the House Report as "clarifying and perfecting changes."[12] But acceptance of petitioner's theory

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[11] The discussion in the *Realty* case of the "fair and equitable" provision formerly in Chapter XI merely buttressed the result reached by the Court upon the fundamental considerations we have previously reviewed.

[12] H. Rep. No. 2320, 82d Cong., 2d sess., pp. 2, 3. See also S. Rep. No. 1395, 82d Cong., 2d sess., p. 20, where in a letter from the Administrative Office of the United States Courts the proposals were referred to as "noncontroversial in character."

that the *Realty* decision was swept aside would mean Congress effected the major and certainly controversial result of permitting a debtor with publicly-held debentures to propose a plan of arrangement under Chapter XI, depriving the debenture holders of their right to absolute priority. An amendment of such grave and far-reaching effect can hardly be read either in the statutory changes Congress made or the explanations it gave in 1952. It may be noted that petitioner's contrary view as to the effect of deleting the "fair and equitable" requirement from Chapter XI received no acceptance by the dissenting judge below or by the different panel of the court below which decided that Chapter XI was proper for the debtor in *In re Transvision Inc.*, 217 F. 2d 243, certiorari denied, 348 U. S. 952.[13] Nor have the sponsors of the amendment suggested that it has had this result.[14]

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[13] We should state explicitly our view—with which compare the concurring opinion of Judge Frank (R. 90a) and the dissent of Judge Galston (R. 90a–91a)—that the decision below in the instant case is inconsistent with the principles followed in *Transvision*. For the reasons stated in this brief and in our petition for certiorari in *Transvision*, we think that case was incorrectly decided.

[14] The General Counsel for the National Association of Credit Men in a discussion of the 1952 amendments stated with respect to Chapter XI:

"Complementing the more cumbersome and costly procedure required by Chapter X, it provides a means for readjustment of the debt structure of enterprises large or small which are not affected by a public interest." Mont-

The pertinent materials all serve to refute petitioner's conclusion that the Commission has failed "over the past seventeen years to obtain recognition of its position from the Congress" (Pet. Br. 41). The statement is answered, not only by the 1952 amendments just reviewed, but also by earlier events which reflect Congressional understanding of the type of problem presented here and in the *Realty* case and approval of the Commission position there vindicated by this Court. While the *Realty* case was in the courts, a bill was pending in Congress which would have excluded from the definition of debtor in Section 306 (3) (Chapter XI) of the Act "a corporation if any class of securities of such corporation is owned by one hundred or more persons." Securities were therein defined to include both creditor and stock interests.[15] The bill also contained provisions relating to the basis of property for income tax purposes when a proceeding under Chapter X, XI or XII results in a cancellation or reduction of indebtedness. The House Committee found that prompt enactment of the income tax feature of the bill was necessary. However, it struck the above

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gomery, *Chapter XI and Recent Amendments*, 58 Commercial Law Journal 11, 14 (1953).

The National Association of Credit Men is a component of the National Bankruptcy Conference, which made the recommendations reflected in the 1952 amendments. See S. Rep. No. 1395, 82d Cong., 2d sess., p. 2.

[15] H. Rep. No. 2372, 76th Cong., 3d sess., pp. 5–6.

quoted provision which would have re-defined a debtor in a Chapter XI proceeding, because, although agreeing that the provision was "desirable," it found that "the element of emergency requiring * * * immediate passage has been eliminated by the decision of the United States Supreme Court in *Securities and Exchange Commission* v. *U. S. Realty & Improvement Company*."[16]

This Commission felt that there was no further need for legislation. It stated in its report to

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[16] *Id*, at p. 2. The Committee Report's full statement in this regard is as follows:

"Sections 4, 5, 6, and 7 of the bill, which are eliminated by the last of your committee's amendments, provided for amendments to chapter XI of the Bankruptcy Act which were designed to prevent corporations which are publicly indebted or owned from filing a petition for an arrangement under chapter XI, rather than a petition for reorganization under chapter X, the chapter specially designed for the reorganization of such corporations, and to establish a numerical test of such "public" indebtedness or ownership.

"Your committee believes that, while the amendments proposed by sections 4, 5, 6, and 7 are desirable, the element of emergency requiring their immediate passage has been eliminated by the decision of the United States Supreme Court in *Securities and Exchange Commission* v. *U. S. Realty and Improvement Company*. That decision was rendered on May 27, 1940, after the introduction of the bill. Since immediate action on these proposals does not appear to be necessary, the first of your committee's amendments provides for the striking out of sections 4, 5, 6, and 7. The committee's conclusion is supported by all of the witnesses who testified at the hearings before the committee's Subcommittee on Bankruptcy and Reorganization and also by the report of the Securities and Exchange Commission on the bill."

Congress with reference to the Court's decision in the *Realty* case:

> It appears, therefore, to be finally settled that resort to the provisions of Chapter XI is not appropriate in the reorganization of corporations with securities distributed in the hands of the public.[17]

Thereafter, until the decision in *In re Transvision,* 119 F. Supp. 134 (S. D. N. Y., 1953), affirmed, 217 F. 2d 243 (C. A. 2, 1954), certiorari denied, 348 U. S. 952, we believe there have been no cases where debtors with public investors utilized Chapter XI over the objection of this Commission.[18]

Subsequent to the *Transvision* decision, a motion of the Commission to dismiss the Chapter XI proceeding or transfer it to Chapter X was denied in *In re Wilcox-Gay Corporation,* 133 F. Supp. 548 (W. D. Mich., 1955), appeal pending. A similar decision was rendered in *In re Liberty Baking Company* (S. D. N. Y. No. 91173) on December 19, 1955 (printed in Appendix B).

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[17] Sixth Annual Report of the Securities and Exchange Commission (1941), p. 57.

[18] Reorganization proceedings where Chapter XI was attempted to be utilized until objection was made by the Commission include *In re Chancellor Hall* (E. D. Pa., No. 22213) (1943); *In re Solar Manufacturing Company* (S. D. N. Y., No. 85855) (1948); *In re American Silver Corporation* (S. D. Cal., No. 45,818–B) (1948); *In re Universal Camera Corporation* (S. D. N. Y., No. 88601) (1952); *In re Tele-Tone Corporation* (S. D. N. Y., No. 88448) (1952); *In re Lowell Adams Factors Corporation* (S. D. N. Y., No. 89575) (1953).

The corporations involved in these two cases had both publicly held debentures and stock and in the latter case the arrangement proposed to alter the rights of debenture holders.

4. THE FACT THAT THE PUBLIC INVESTORS HERE ARE STOCKHOLDERS RATHER THAN CREDITORS CONSTITUTES NO REASON FOR DISTINGUISHING THE *REALTY* CASE

Petitioner seeks to distinguish this case from the *Realty* case on the ground that here the only public investors are stockholders (Br. 14, 19, 28–31). But petitioner's own observation (Br. 20) that neither stockholders nor this Commission on their behalf has any status under Chapter XI except to raise the question whether the debtor should properly be under Chapter X (Br. 20) serves to emphasize the need in a case like this for application of Chapter X, where the numerous protections for public investors are specifically made available to stockholders as well as to creditors.[19] Petitioner argues in this connection (Br.

[19] There is specific provision, for example, in Chapter X for notice to stockholders of the hearing for "objections to the continuance of the debtor in possession, or to the retention in office of a trustee upon the ground that he is not qualified or not disinterested * * *." Sections 161, 162. The trustee's statement as to "his investigation of the property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof" must be sent to stockholders. Section 167 (5). Stockholders may submit suggestions for the formulation of a plan and are to be given notice of this opportunity by the trustee as well as notice of all hearings on plans. Sections 167 (6) and 169–171. When a plan is approved, stockholders have for their consideration in determining whether to accept it the plan itself and all other approved plans "together with

20, 33) that neither the Commission nor stockholders may intervene where an adjudication in bankruptcy is sought, apparently to prove that they may not intervene in Chapter XI where the public interest is in the stock. But this ignores both the *Realty* holding and the specific provisions of Section 328. More significantly, it fails to recognize that most of the problems involved in reorganization are not involved in bankruptcy.[20]

In its effort to show that the result in the *Realty* case is inapplicable where the public in-

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a summary thereof approved by the judge," the judge's opinion of approval if any or an approved summary thereof, "the report, if any, filed * * * by the Securities and Exchange Commission * * * or a summary thereof prepared by the Securities and Exchange Commission", and "such other matters as the judge may deem necessary or desirable for the information of creditors". Sections 174–175. If the debtor has not been found to be insolvent the vote of a majority of each class of stock affected by the plan is normally required before a hearing is held on confirmation and the hearing must be on notice to stockholders. Section 179.

[20] "Reorganization involves all the problems of corporate finance and management: it requires an inquiry into the causes of the financial collapse of the corporation; and its worth if salvaged as a going concern; and, if reorganization instead of liquidation is determined upon, how this can best be accomplished upon a basis not only fair but economically sound." Securities and Exchange Commission, *Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees*, Part VIII (1940), p. 1. See also the fuller summary set forth in *Warner Bros. Pictures* v. *Lawton-Byrne-Bruner Insurance Agency Company*, 79 F. 2d 804, 815 (C. A. 8).

vestors are stockholders, petitioner urges (Br. 28 *et seq.*) that the transfer from Chapter XI to Chapter X entails disadvantages for both the debtor and its stockholders. Only Chapter XI, petitioner argues (Br. 28), permits a composition, under which a majority of creditors can bind all to accept a reduction in their claims while leaving intact the stock interests. Hence, it is contended that the stockholders lose an important advantage if the debtor is required to utilize Chapter X (Br. 28). This argument is predicated in part upon the elimination in the 1952 amendments to the Bankruptcy Act of the "fair and equitable" requirement for a Chapter XI arrangement (Br. 18, 31). See pp. 28–37, *supra*.

We observe at the outset, that if trade creditors strongly believe that continuance of the debtor as a going concern will operate to their benefit through the opportunity of making future profits and that this might be impossible unless they accept payment of their claims at a discount, nothing in Chapter X prevents them from voluntarily agreeing to do so in an appropriate case, even though holdouts might insist upon and receive full payment.[21] Moreover, the doctrine

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[21] See, *e.g.*, *In re Keeshin Freight Lines, Inc.*, SEC Corp. Reorg. Release No. 78, at 21 (1949), rejected on other grounds, 86 F. Supp. 439 (N. D. Ill.):

"We see no reason why the eleven business corporations and individuals, including such companies as General Motors Corporation, Socony-Vacuum Oil Co., Inc., and

of absolute priority, required under Chapter X by reason of the "fair and equitable" standard (see fn. 9, *supra*, p. 30), might well be satisfied, in its application to merchandise and bank creditors, on the basis of considerations different from those involving public holders of debt obligations. Compare the *Realty* case, 310 U. S. at 454, where this Court pointed out, at a time when Chapter XI still had the provision that the plan must be "fair and equitable", that "where there are no public or private interests involved requiring protection by the procedure and remedies afforded by Chapter X", there might, under Chapter XI, be a "reduction of the claims of the prior creditors without alteration of the management's interests," if this would be compensated for by "the preservation of going-concern value through their continued management of the business * * *."[22]

Baltimore & Ohio Railroad Company, who hold the parent company's notes, may not accept, voluntarily, parity treatment among themselves. These are not members of the investing public with respect to whom the proposal would be subject to serious criticism upon the grounds of unfairness."

[22] And cf. *In re Muntz TV Inc.*, SEC Corp. Reorg. Release Nos. 95 and 96 (1955), approved, N. D. Ill., E. Div., No. 54B 491, where a plan was found fair to unsecured creditors consisting of "primarily trade creditors, most of whom are continuing to supply merchandise to the debtors, and who, it is expected, will continue this business relationship after the reorganization." SEC Corp. Reorg. Release No. 96 at p. 4. The plan permitted stockholder participation despite

In any event, even assuming that there are advantages for stockholders under Chapter XI which are unavailable under Chapter X, the fact remains that, as held in *Realty*, the debtor may not choose which chapter shall be employed depending upon the type of relief it seeks (pp. 21-23, *supra*). This holding is particularly necessary insofar as the diminution of creditors' rights under Chapter XI is precluded under Chapter X. Congress did not intend that the rights of those having claims against the debtor could vary in accordance with the discretionary choice by management of one chapter or the other.[23]

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the fact that the trade creditors were limited to receiving 75% of their claims in non-interest bearing promissory notes and the balance in voting preferred stock, where, as compensation for the lack of interest on the notes, a creditors committee was given the right in effect to name three of the five members of the Board of Directors until the notes should be paid.

[23] Petitioner also urges (Br. 34) that wage claimants will lose priorities granted by Section 64 of the Bankruptcy Act if it should proceed under Chapter X. In the summary of assets and liabilities contained in the affidavit of the debtor's president, the wage claims to which this argument relates are listed at $440.47 (R. 41a). But even apart from its insignificance in this case, the argument lacks merit. We are aware of no Chapter X case where wage claims for services during the course of the proceedings and for at least several months prior thereto have not received priority and of no instance where this practice has been questioned, except by the wage claimants here. Presumably the courts give recognition to the priority of wage claims on the basis of equitable principles of distribution, such as the "six months rule" applied in equity reor-

Moreover, if the possible advantages of Chapter XI for stockholders were far more substantial than they are, they could not outweigh the plain fact that the same considerations of public policy —the same concern for numerous, frequently unprotected and uninformed public investors—which were decisive in *Realty* are operative whether the investors are "creditors" or "stockholders." Nor is this critical point weakened because, as appears to be true in the instant case, trade creditors may be satisfied with a proposed arrangement under Chapter XI. Even where such creditors are willing to take substantially less than face amount because it is to their interest to have the debtor continue in business, as is possible here, such continuance in business might lead to the dissipation of an existing equity for stockholders, a possibility which, as Judge Clark noted in the opinion below (R. 88), merits careful exploration in the circumstances of this case. Under Chapter X the examination by an independent trustee pursuant to Section 167 would appraise this possibility and give stockholders an opportunity to make an informed choice as to whether or not they should favor any plan continuing the debtor in business. It cannot be expected that manage-

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ganizations. Cf. *Dudley* v. *Mealey*, 147 F. 2d 268 (C. A. 2), certiorari denied, 325 U. S. 873. Of course, wages during the course of the proceeding would be entitled to an express priority under Chapter X as administrative expenses. Section 216 (3) of the Act.

ment, which presumably continues in office so long as operations continue, would be as objective respecting future risks as would an independent trustee.[24]

If continuance of the business should be the ultimate determination, a complete reorganization embracing the debtor's subsidiaries may be required, and is available under Chapter X, insuring that the result of the proceeding would not be merely "to place crutches under [a] corporate cripple * * *" and send it "out into the business

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[24] The House Report on the Chandler Act, in setting forth the abuses to be remedied, quoted the following statement of Mr. Justice (then S. E. C. Chairman) Douglas (H. Rep. No. 1409, 75th Cong., 1st sess., p. 38):

"Management usually remains in dominance of the situation during and after reorganization, as before. It meets only casual scrutiny, at most; its plan is adopted; it does not account. Good, bad, or indifferent management continues in the saddle. It is beyond question that in many cases which are matters of public record, this state of affairs has resulted in hardship and loss. And I believe it equally beyond question that the present method promotes and induces superficial, surface reorganizations which leave uncured dangerous diseases in the corporate body; and that this superficiality of method thwarts the objective of reorganization—the production of a fair and equitable plan and the launching of a vital business enterprise under able, faithful management. * * *"

Cf. Rostow and Cutler, *Competing Systems of Corporate Reorganization: Chapters X and XI of the Bankruptcy Act*, 48 Yale Law Journal 1334, 1337 (1939):

"* * * Chapter XI offers tremendous advantages of procedure and of result to corporate management, and to the security interests usually held by management."

world to be a menace to all who might purchase * * * [its] securities or deal with * * * [it] on credit."[25] This and other considerations far outweigh petitioner's objection that a Chapter X proceeding entails somewhat greater expense than one under Chapter XI. In the first place, the expense of a single, adequate Chapter X proceeding is obviously worthwhile if it eliminates the cost of a further reorganization which might otherwise be necessary within a few years. Moreover, in a particular case, the independent Chapter X trustee might uncover causes of action on behalf of the stockholders against existing or former management which otherwise might be lost, either because they might never be discovered, the statute of limitations might expire, or they did not survive the Chapter XI proceeding. Such recoveries in many Chapter X proceedings have been substantial,[26] and in a particular case

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[25] Cf. *Price* v. *Spokane Silver & Lead Co.*, 97 F. 2d 237, 247 (C. A. 8), certiorari denied, 305 U. S. 626.

[26] See *Committee* v. *Kent*, 143 F. 2d 684, 687 (C. A. 4), where it was stated:

"* * * Examination under section 167 is one of the important steps in a reorganization where the court is required to exercise an 'informed, independent judgment' based upon 'adequate, trustworthy information' (*National Surety Co.* v. *Coriell*, 289 U. S. 426, 436); and stockholders should not be denied the benefit of a thorough and efficient investigation merely because the assets presently in hand would go to bondholders or debenture holders upon the winding up of the corporation's affairs."

The investigation in that case led to a judgment on behalf of the debtor in excess of $14,000,000, which was ultimately

may more than offset savings resulting from a composition with the creditors. Thorough examinations have also led to subordination of senior claims to stock interests.[27]

Finally, we note petitioner's assertion (Br. 29) that there is a "loss in a proceeding under Chap-

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reversed by reason of the running of the statute of limitations. *Austrian* v. *Williams*, 103 F. Supp. 64 (S. D. N. Y.), reversed, 198 F. 2d 697 (C. A. 2), certiorari denied, 344 U. S. 909. In other cases, however, our experience has shown that substantial amounts have been obtained in reorganizations as a result of prosecutions of actions against former officials. See, *e. g.*, *Gerdes* v. *Reynolds*, 28 N. Y. S. 2d 622 (1941), which arose out of *Reynolds Investing Co., Inc.* (D. N. J. No. 27863); *Heiner* v. *North American Coal Corp.*, W. D. Pa., No. 1756 (1941), *Same*, Common Pleas Court, Philadelphia County, Pa., No. 1854 (1942), *Same*, D. Md., No. 1468 (1942), *Same*, M. D. W. Va., No. 117–W (1942), *Same*, N. D. Ohio (E. D.), No. 21081 (1942), *Same*, Common Pleas Court, Allegheny County, Pa., No. 3311 (1942), all of which arose out of *In re Pittsburgh Terminal Coal Corporation*, W. D. Pa., No. 20716; *Rabinowitz* v. *Nelson*, N. Y. Sup. Ct. (N. Y. Co., No. 30597, 1944) which in turn arose out of *In re Lower Broadway Properties, Inc.*, S. D. N. Y., No. 81840; *Adolf Gobel, Inc.* v. *Skipworth et al.*, 3 N. W. 2d 551 (Sup. Ct., Iowa, 1942) which arose out of *In re Adolf Gobel, Inc.*, S. D. N. Y. No. 79526. *Cf. Ladd* v. *Brickley*, 158 F. 2d 212 (C. A. 1), certiorari denied, 330 U. S. 819, rehearing denied, 330 U. S. 855, which arose out of the reorganization of *International Hydro-Electric System* under Section 11 (d) of the Public Utility Holding Company Act of 1935, see 26 S. E. C. 623 (1947).

[27] *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307; and see *Columbia Gas & Electric Corp.* v. *United States*, 151 F. 2d 461 (C. A. 6), certiorari denied, 329 U. S. 737.

ter X of all the experienced management of the debtor." Under Chapter X, however, officers or other members of management can be retained, where deemed desirable, by being employed by the trustee,[28] or if necessary by appointment "as an additional trustee" for the limited purpose of operating the business and managing the property of the debtor.[29] Thus, assuming that the experience of petitioner's present management will be necessary to petitioner's rehabilitation in the new operations on which it has embarked—a matter which may itself warrant exploration under Chapter X, considering the recent history and present circumstances of the corporation as well as the fact that the present management dates only from 1951—this benefit is entirely available in Chapter X proceedings along with the other advantages and protections such proceedings afford.

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[28] Section 191 of the Act.

[29] It is provided in Section 156 of the Act: "In any case where a trustee is appointed the judge may, for the purposes specified in section 189 of this Act, appoint as an additional trustee a person who is a director, officer, or employee of the debtor." Section 189 relates to a trustee's duty to "operate the business and manage the property of the debtor."

CONCLUSION

For the foregoing reasons the judgment of the court below should be affirmed.

Respectfully submitted.

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DECEMBER 1953.

APPENDIX A

Comparison of Provisions of Chapter X and Chapter XI

	Chapter X	Chapter XI
1. Initiation of proceeding.	Debtor, three creditors, or indenture trustee may file petition (Sec. 126).	*Only* debtor may file petition (Secs. 321, 322).
2. Appointment of trustee.	Trustee appointed in every case in which indebtedness is $250,000 or more (Sec. 156).	*No comparable provision.* If trustee in bankruptcy has already been appointed, he must be continued in possession. Otherwise, receiver may be appointed "if necessary" (Secs. 332, 343).
3. Qualifications of trustee.	Must be independent, disinterested (Secs. 156, 158).	*No comparable provision.*
4. Examination of Debtor's financial problems and causes of failure.	Trustee investigates property, liabilities, and financial condition of debtor, the operation of the business, and the desirability of its continuance (Sec. 167 (5); *cf.* Sec. 167 (1)). See also Sec. 21 (a).	Court *may* direct examination by creditor or other party of witnesses concerning acts, conduct, or property of Debtor (Sec. 21a).
5. Report to judge upon past conduct of the Debtor.	Trustee reports to judge facts pertaining to fraud, misconduct, mismanagement and irregularities, and any causes of action available to estate (Sec. 167 (3)).	*No comparable provision.*
6. Reports to security holders.	Trustee submits statement of his investigation to security holders (Sec. 167 (5)).	*No comparable provision.*
7. Formulation of plan.	Trustee gives notice to security holders that they may submit to him suggestions for formulation of plan (Sec. 167 (6)).	*No comparable provision.*
8. Proposal and filing of plan.	Trustee prepares and files plan (or report of reasons why plan cannot be effected) *before* debtor may propose plans or amendments (Sec. 169).	*Only* debtor may propose arrangement (Sec. 323) or modifications (Sec. 363).
9. Assistance of administrative agency.	In cases in which the scheduled indebtedness exceeds $3,000,000, and in other cases if the judge desires, plans which the judge finds worthy of consideration, after hearing, are submitted to the Securities and Exchange Commission for examination and report (Secs. 172, 173). Commission may, with approval of judge, participate in proceeding as a party (Sec. 208).	*No comparable provisions.*
10. Fairness of plan.	Plan may be approved and confirmed only if "fair and equitable, and feasible" (Secs. 124 and 221 (2)).	Plan may be confirmed if in "best interests of the creditors and is feasible" (Sec. 366).
11. Submission of plans for acceptances.	*After* approval by the judge as fair and equitable, and feasible, plans are transmitted to security holders together with informative materials, including the judge's opinion and the Commission's report (Secs. 174, 175).	*No comparable provision*

	Chapter X	Chapter XI
12. Solicitation of acceptances.	May not normally be solicited until *after* judge has approved plan and informative materials have been transmitted (Sec. 176).	May be solicited at any time, even prior to institution of proceeding, and must be obtained *before* court confirms arrangement (Secs 336 (4), 361, 362). No requirement as to data which must accompany solicitation.
13. Acceptances required for confirmation.	Two-thirds in amount of each affected class of creditors and majority of holders of stock (if debtor is not insolvent) (Sec. 179).	Majority in amount and number of each affected class of unsecured creditors (Sec. 362 (1)).
14. Dissenting classes of creditors or stockholders.	If a class of creditors does not accept by two-thirds in amount, or if a class of stockholders does not accept by a majority, the plan may be confirmed if it provides for such classes adequate protection as prescribed by the statute (Secs. 216 (7), (8), 179, 221).	*No comparable provisions.*
15. Classes of security holders which plan may affect.	Plan may alter and modify the rights of any class of creditors, secured or unsecured, and of any class of stockholders (Sec. 216).	Arrangement may provide for settlement, satisfaction, or extension of unsecured debts only (Secs. 306 (1), 357).
16. Participation in proceeding by security holders.	Have right to be heard on all matters arising in proceeding (Sec. 206); and may act in person, by attorney, or by agent or committee (Sec. 209).	*No comparable provision.* A creditors' committee may be selected at or before first meeting of creditors (Sec. 338).
17. Control over representatives of security holders.	Information furnished to court concerning employment and interests of representatives of security holders (such as committees, indenture trustees and attorneys), as well as interests of the persons represented (Secs. 210, 211). The judge is empowered to disregard provisions in authorizations of such representatives or to restrain the exercise of powers which are unfair or contrary to public policy (Sec. 212). Claims or stock acquired by the representatives in contemplation of or during the course of proceeding may be limited to actual consideration paid therefor (Sec. 212).	*No comparable provisions.*
18. Indenture trustees.	Have the right to be heard on all matters arising in the proceeding (Sec. 206); to file a claim on behalf of all holders of securities outstanding under their indenture (Sec. 198); and to file a petition initiating the proceeding under the chapter (Sec. 126).	*No comparable provisions* and no mention of indenture trustees.

	Chapter X	Chapter XI
19. Lists of security holders.	Trustee is under a duty to prepare and file lists of security holders (Sec. 164). Other persons in possession or control of such lists or information relevant thereto may be required to disclose the lists or such information (Sec. 165). Although in a proper case the court may direct impounding of the lists, bona fide security holders and indenture trustees have an unqualified right to use and inspect them upon terms prescribed by the court (Sec. 166).	*No comparable provisions.* Debtor files bankruptcy schedules with petition (Sec. 324).
20. Compensation and allowances	In addition to allowances to officers of the court, the debtor and petitioners, the judge has broad power to make reasonable allowances of compensation and reimbursement for expenses to the representatives of security holders, including committees and indenture trustees, and to individual creditors and stockholders and their attorneys. (Secs. 241-242.)	The debtor is required to deposit the money necessary "to pay the costs and expenses of the proceedings, and the actual and necessary expenses, in such amount as the court may allow," incurred by a creditor's committee (Sec. 337 (2).)
21. Subsidiary corporations.	A petition by or against a subsidiary corporation may be filed in the same court which has approved the petition by or against the parent corporation. (Secs. 129, 106 (33).)	*No comparable provision*, and no mention of subsidiaries.
22. Future management.	Plan must contain provisions which are equitable, compatible with the interests of security holders, and consistent with public policy, with respect to the manner of selection of the reorganized company's directors and officers (Sec. 216 (11)); and identity, qualifications, and affiliations of the persons to be directors and officers must be disclosed and meet same test. (Sec. 221 (5).)	*No comparable provision.*
23. Charter of reorganized company.	Plan must contain provisions requiring inclusion in the reorganized company's charter of provisions for the prohibition of the issuance of nonvoting stock, for the equitable distribution of voting power among the new securities possessing such power, for the election of directors representing preferred stockholders in the event of default in payment of preferred dividends, for the general fair and equitable treatment of securities, and for periodic corporate reports to security holders. (Secs. 216 (12).)	*No comparable provision.*

APPENDIX B

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

No. 91173

IN THE MATTER OF LIBERTY BAKING CORPORATION, DEBTOR

MEMORANDUM

Filed: U. S. District Court, S. D. of N. Y., Dec. 19, 1955

NOONAN, *D. J.*

The Securities and Exchange Commission has moved herein for leave to intervene and to (1) dismiss the Debtor's petition, (2) refuse confirmation of the Debtor's arrangement, and (3) to dismiss the proceeding unless the petition be amended, or a creditors' petition be filed, conforming to the provisions of Chapter X of the Bankruptcy Act.

In brief, this is another case wherein the Securities and Exchange Commission feels that there is a sufficient public interest to warrant the court setting aside all that has gone before, in the proceedings already had pursuant to Chapter XI of the Bankruptcy Act.

The growing problem that this type of case raises for parties, the bar and the bench, is referred to in the October 1955 issue of the Journal of the National Association of Referees in Bankruptcy, Vol. 29, p. 139.

The Transvision case (*in re Transvision, Inc.*, 119 F. Supp. 134, aff'd 217 F. 2d 243; cert. den'd 348 U. S. 952) is authority for the proposition that public ownership of a substantial portion of the stock is not, per se, proof of sufficient public interest to call for all of the safeguards of a Chapter X proceeding. The latter procedure is designed to protect unsecured creditors in general rather than stockholders alone.

Inevitably, by virtue of the wording of the Act itself, the determination of each case must rest on its own merits and on its own special state of facts with regard to the debtor's financial and debt structure.

In the instant case, the debtor has the following securities outstanding:

(1) 4% debentures due in 1978—$1,602,420 (of which 35% in value is in the hands of management, former and present);

(2) 791 shares of $4 preferred stock, all in the hands of 27 members of the public;

(3) 43,064 7/20 shares of no par common stock, of which 79% is held by management.

The debtor is a holding company and its sole asset is the entire capital stock of Bell Bakeries, Inc., which owns and operates bakeries in six states. Since Liberty is not in any separate business, its liabilities are generally limited to its debentures.

The latest annual consolidated balance sheet for the debtor and its wholly-owned subsidiary (dated January 1, 1955) lists the total assets at $3,237,731 and the total liabilities at $3,961,416, indicating a net capital deficiency of $723,685.

Although the debtor, through its subsidiary, has shown substantial losses over the past few years, its latest balance sheet shows a gain.

The subsidiary corporation filed a petition under Section 322 of the Bankruptcy Act and an arrangement was proposed and confirmed by the Court whereby unsecured creditors are to be paid 65% in quarterly installments over a 4½ year period. In the Bell Baking Co. proceeding, trade creditors filed claims in the amount of $685,672, thus obligating the subsidiary (whose stock is the sole asset of the current debtor) to pay out almost $450,000 in regular installments over 4½ years.

The proposed arrangement herein contemplates a merger of the two corporations, and the issuance of $1 par preferred stock to holders of the debtor's outstanding debentures in the sum of $1,602,420 (at the rate of one share for each sixty dollars of debenture), which stock is to pay dividends of $2.50 a share, but remain limited to $50 per share in liquidation by lot, and to be temporarily non-cumulative so as to permit the subsidiary company's obligations to be met.

According to the facts and figures of this case, there are only 333 public holders, holding approximately 27,000 securities of all types; of this group only 198 are debenture holders.

The proposed arrangement provides that, after conversion of the debentures to preferred stock, the new preferred stockholders will elect 3 of the 7 directors. It further provides that, in the event of certain defaults in payment, these new preferred stockholders may elect the entire Board

of Directors. The debentures came into being by a previous conversion from preferred stock; the arrangement under consideration would reconvert the debentures back into preferred stock. The debtor's financial structure is and will be relatively simple.

In view of all of the above, it does not seem that the proposed arrangement affects a substantial public interest.

In the *Transvision case* (supra), Judge Medina stated, at page 246:

> "Indeed, the Bankruptcy Act itself, in requiring every petition under Chapter X to state 'Why adequate relief cannot be obtained under Chapter XI' Bankruptcy Act, Sec. 130 (7), 11 U. S. C. A. Sec. 530 (7), and in declaring that 'A (Chapter X) petition shall be deemed not to be filed in good faith if * * * (2) adequate relief would be obtainable by a debtor's petition under the provisions of chapter II of this title', Bankruptcy Act Sec. 146, 11 U. S. C. A. Sec. 546, manifests a conscious purpose of Congress to encourage resort to Chapter XI whenever the remedy afforded thereby adequately protects the interests involved."

It is the opinion of this court that the remedy afforded by the arrangement as worked out between management and the creditors' committee adequately protects the interests involved, and that to require the parties to go through a Chapter X proceeding would be needless and time-consuming, as well as the cause of further expense to all parties.

It is, therefore, the ruling of this court that the petition of the Securities and Exchange Commission for leave to intervene, and for certain other relief referred to in the beginning of this opinion, should be, and hereby is, denied.

So ordered.

Dated: New York, N. Y., December 19, 1955.

GREGORY F. NOONAN,
U. S. D. J.

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No. 170

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IN THE

Supreme Court of the United States

OCTOBER TERM 1955

GENERAL STORES CORPORATION,

Petitioner,

vs.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS' COMMITTEE and WAGE CLAIMANTS,

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF THE CREDITORS COMMITTEE

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No. 170

IN THE

Supreme Court of the United States

OCTOBER TERM 1955

GENERAL STORES CORPORATION,

Petitioner,

vs.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS COMMITTEE and WAGE CLAIMANTS.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF THE CREDITORS COMMITTEE

The Creditors Committee joins with the petitioner, General Stores Corporation, in seeking reversal of the judgment of the Court of Appeals for the Second Circuit, dated April 14, 1955, which by a divided court affirmed the judgment of the United States District Court for the Southern District of New York, entered on March 7, 1955. The decision of the Court below prevents the petitioner and its unsecured creditors from utilizing the procedures of Chapter XI of the Bankruptcy Act on the ground that Chapter XI is not available to large corporations whose stock is publicly held.

Statement of the Case

On October 18, 1954, General Stores Corporation filed a petition in the District Court for the Southern District

of New York, in accordance with the provisions of Section 322* of Chapter XI of the Bankruptcy Act, in which it proposed an arrangement of its general unsecured obligations (R. 43a). Under the plan, such creditors would receive 100% of their claim, 20% upon confirmation of the plan and 20% annually thereafter. Statutory priority creditors would be paid in full (R. 14a).

Prior to the filing of the Chapter XI petition, General Stores Corporation conducted a chain of retail cigar stores (R. 42a). It owned the entire capital stock of Stineway Drug Company and Ford Hopkins Company, which subsidiary companies operate drug-restaurant chains in Chicago and midwestern states (R. 37a). However, all of the capital stock of these subsidiaries is pledged with the seller to secure the payment of notes representing the balance of the purchase price, approximately $2,000,000 (R. 43a, 46a). Under the agreement of purchase, these notes become immediately due and payable, with the consequent right of foreclosure on the collateral, in the event that a trustee is appointed for the purchaser or the purchaser files a petition for relief under any chapter of the Bankruptcy Act. The petitioner has obtained a waiver of this provision with respect to the present proceedings for an arrangement. *This waiver, however, does not extend to a Chapter X proceeding* (R. 46a).

The petitioner's capital structure consists of a little over 2,000,000 shares of $1.00 par common stock held by approximately 7,000 stockholders and listed on the American Stock Exchange (R. 30a). It has only one class of stockholders (R. 43a) and two classes of creditors, namely, priority creditors (in the main, for wages and taxes) and general unsecured creditors (in the main, merchandise and service creditors, former employees and landlords on rejected leases) (R. 40a, 42a).

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*11 U.S.C. 722, 52 Stat. 907

During the administration of these proceedings the petitioner rejected all of its existing executory lease agreements covering its retail cigar stores and converted into cash all of its merchandise inventory, fixtures and equipment, so that the assets of the petitioner now consist solely of (1) cash on hand and (2) petitioner's equity in all of the capital stock of the aforementioned subsidiaries (R. 54a), which obviously have value to the debtor only as going concerns.

In the course of these proceedings, it became apparent that the cash obtained by liquidation of the assets of the debtor was such as to require modification of the plan of arrangement as filed by the debtor. A proposal to pay the equivalent of 40% of unsecured creditors' claims in full satisfaction thereof was offered to the members of the Creditors Committee for its consideration, a majority of whom indicated that they would recommend acceptance of such amended plan if formally submitted.

No alteration, reorganization or change of the stock of the debtor or the interests or rights of stockholders is sought in these proceedings nor is any contemplated.

Summary of Argument

(1) The decision below prevents the debtor and its creditors from effecting a composition of the debtor's unsecured obligations pursuant to Chapter XI, despite the fact that a transfer of these proceedings to Chapter X, with the resultant delay, increased expenses and dissipation of assets, works to the disadvantage of all interests concerned. All this, notwithstanding the absence of the need for a reorganization of the debtor or the investigatory procedures of Chapter X.

(2) The decision below is the result of the misinterpretation of the decision of this Court in the *Realty** case and

* *Securities and Exchange Commission v. U. S. Realty & Improvement Co.*, 310 U. S. 434.

other decisions. The *Realty* case is inapplicable to the present case for the following reasons:

First, the factual situations presented in the *Realty* case and the instant case are dissimilar, particularly with reference to the debt structure of the respective debtors.

Second, the 1952 amendments of the Bankruptcy Act eliminated the "fair and equitable" standard, theretofore applicable to Chapter XI, which standard prompted the decision in the *Realty* case.

(5) Congress did not intend nor does the Bankruptcy Act by its terms preclude a large corporation with publicly owned stock from composing its unsecured debts, absent a reorganization of its capital structure. For that purpose, Chapter XI provides the only appropriate procedure and therefore the sole remedy.

THE ARGUMENT

The Court below erred in denying the debtor the right to proceed under Chapter XI solely because the debtor is a large corporation with publicly held stock.

The Court below declared that a debtor-corporation whose stock is listed on a stock exchange and publicly held may not compose its unsecured obligations unless it resorts to the elaborate investigatory, cumbersome and expensive procedures involved in a reorganization pursuant to Chapter X of the Bankruptcy Act. This despite the fact that neither the debtor, its creditors, nor its stockholders, seek a reorganization of the debtor.

The creditors view the compulsory transfer of these proceedings to Chapter X as extremely prejudicial to their rights, for such a transfer must result in unnecessary delay and dissipation of assets which would otherwise be available for application to the claims of creditors.

creditors should receive first consideration, the rights of stockholders being subordinate. The failure to recognize this cardinal principle magnifies the error committed below. No matter how lofty the motives of the Securities and Exchange Commission in suggesting that it alone possesses "adequate means for a disinterested analysis of the debtor's financial condition, the desirability of the continuance of the enterprise as presently constituted or on any other basis" (R. 36a), it is the creditors ultimately who must first be satisfied with the proposal of settlement whether it be by "arrangement" or "reorganization."

It is readily apparent that confirmation of a plan of arrangement pursuant to Chapter XI, which will relieve the debtor of its unsecured indebtedness, must work to the advantage of the petitioner's stockholders. Respondent, Max Shlensky, who owns only 3,000 shares, less than 2/10ths of one percent of the common stock of the petitioner, stands alone among the stockholders in his desire to compel a transfer of these proceedings to Chapter X, casting doubt as to the Circuit Court's statement that the stockholders are "concerned" and "wish some assurance of a fair plan now".* *No other stockholders have since joined with respondent, Shlensky, or sought to intervene in these proceedings.*

The Securities and Exchange Commission, however, argues that the continuance of the Chapter XI proceedings could adversely affect the stockholders because liquidation or reorganization might be merely postponed and in the meantime assets might be dissipated (Br. 42, 44). The record is completely devoid of any showing which even tends to justify this wholly unrealistic contention. There is every indication that a composition of the petitioner's unsecured obligations may be effected pursuant to Chapter XI with a minimum of expense and delay and resultant benefit to all interests concerned. Surely the delay and increased expenses of administration which are concomi-

* See Opinion of Clark, C.J., 222 F. 2d 234, 236.

taints of a Chapter X proceeding will increase the danger of liquidation many fold. It is for that very reason that its creditors are desirous to have these Chapter XI proceedings continue.

It is important to point out that under Section 366 of the Bankruptcy Act,* as amended in 1952, the fundamental requisite for the confirmation of a plan of arrangement pursuant to Chapter XI is that the plan be "for the best interests of the creditors." The creditors must be accorded primary consideration, and it is respectfully submitted that the interests of the creditors would be best served by a continuance of the proceeding in Chapter XI, rather than Chapter X. A transfer of these proceedings to Chapter X would require the appointment of a trustee who, to the extent directed by the Court, would be obliged to undertake an examination and investigation of the Petitioner's liabilities, property, management and numerous other matters relevant to the formulation of a plan. Such measures are totally unnecessary, for the Creditors Committee has conducted an extensive examination into the affairs of the petitioner and there has been no charge of fraud or impropriety. To compel a transfer to Chapter X, in order to incorporate the investigatory procedures of that chapter, will only result in delay and dissipation of the assets of the debtor-petitioner, without deriving the benefits those procedures were designed to afford.

On the other hand, reversal of the judgment below and a continuance of the Chapter XI proceeding will permit the petitioner and its general unsecured creditors to effect a settlement which would, in all probability, result in the creditors receiving 40% of their claim. As previously noted, this proposal received the approval of a majority of the Creditors Committee. Such a proposal is in the best interests of the stockholders of the petitioner, as well as its creditors, for confirmation of a plan of arrangement pursuant to Chapter XI will result in an increase in the

*11 U. S. C. 766, 66 Stat. 433.

value of the stock of the company and the preservation of the stockholders' $2,000,000 investment in its two subsidiaries, Stineway Drug Company and Ford Hopkins Company.

The decision below preventing the petitioner and its creditors from proceeding towards the confirmation of a plan of arrangement pursuant to Chapter XI, is unwarranted under the provisions of the Bankruptcy Act and the previous decisions of this and other courts and is the result of a misinterpretation of the holding of this Court in the *U. S. Realty* case.*

In the *U. S. Realty* case the debtor had assets of $7,076,515 and liabilities of $5,051,416, of which only $74,916 was current. This indebtedness included two series of publicly held debentures aggregating $2,339,000, which were secured by corporate stock, and a $3,000,000 note secured by a first mortgage held by the debtor. The debtor was also liable as a guarantor of mortgage certificates in the sum of $3,710,500 issued by its wholly-owned subsidiary and held by some 900 holders. It was this latter obligation which the debtor sought to modify by a plan pursuant to Chapter XI.

This Court, limiting its decision to the particular situation presented,† held that the question whether any "fair and equitable" arrangement could be effected without readjustment of the capital structure of the debtor could best be answered in a Chapter X proceeding.

In the first instance it is noted that the debt structure of the petitioner in the present case is dissimilar to that of the debtor in the *U. S. Realty* case. The petitioner debtor does not have any debentures, bonds, mortgages, notes or any like obligations in the hands of the general public. It has but one class of stockholders. Indeed, the entire

* *Securities & Exchange Commission* v. *U. S. Realty & Improvement Co.*, 310 U. S. 434

† *Id.*, at page 454

corporate structure of the debtor-petitioner is one of complete simplicity.

Secondly, the decision in the *U. S. Realty* case is based upon the law as it then existed that any plan of arrangement under Chapter XI had to meet the "fair and equitable" standard. At 310 U. S. 434, 452, the Court wrote:

> "'Fair and equitable,' taken from § 77B and made the condition of confirmation under both Chapter X and Chapter XI are 'words of art' having a well understood meaning in reorganizations in equitable receiverships and under § 77B which is incorporated in the structure of both Chapters X and XI. See Case v. Los Angeles Lumber Products Co., 308 U. S. 106, 115 et seq., 60 S. Ct. 1, 7, 84 L. Ed. 110. The phrase signifies that the plan or arrangement must conform to the rule of Northern Pacific Ry. Co. v. Boyd, 228 U. S. 482, 33 S. Ct. 554, 57 L. Ed. 931, which established the principle which we recently applied in the Los Angeles case, *that in any plan of corporate reorganization unsecured creditors are entitled to priority over stockholders to the full extent of their debts, and that any scaling down of the claims of creditors without some fair compensating advantage to them which is prior to the rights of stockholders is inadmissible.*" (Emphasis ours.)

In 1952 Congress amended Section 366 of the Bankruptcy Act * and eliminated the requirement that a plan of arrangement must be "fair and equitable". The House of Representatives, in its report accompanying amendatory bill S2234 (House Report No. 2320, 82nd Cong., 2nd Sess., in substance being the same as Senate Report No. 1395), said (2 U. S. Cong. & Adm. News '52, 1981):

> "These sections (Secs. 366, 472 and 656a) presently require a finding that a proposed plan under chapters XI, XII, and XIII shall be 'fair and equitable'. In fact, however, the fair and equitable rule, as interpreted in Northern Pacific Railway Co. v. Boyd, 228 U. S. 482, 33 S. Ct. 554, 57 L. Ed. 931 (1913) and

* 11 U. S. C. 766; 66 Stat. 433.

Case v. Los Angeles Lumber Products Co. Ltd., 308 U. S. 106, 41 Am. B. R. (N. S.) 110, 60 S. Ct. 1, 84 L. Ed. 110 (1939), cannot realistically be applied in a chapter XI, XII, or XIII proceeding.

"Chapter XI has replaced the old composition procedure under former section 12 of the Bankruptcy Act, where the fair and equitable rule did not apply. Nor is it practicable or realistic to apply the rule in a proceeding under chapter XI, XII, or XIII.

"The proposed amendment is designed to remove the fair and equitable provision, and by the paragraph added to each of the amended sections† it is made clear that the rule of the Boyd and Los Angeles cases shall not be operative under those three chapters." (Interpolation ours.)

This renunciation by Congress of the rule laid down in the *Boyd* and *Los Angeles* cases, which prompted the majority decision in the *U. S. Realty* case, would appear to give greater credence to the minority decision. Judge Roberts in his dissent (concurred in by the then Chief Justice Hughes and Mr. Justice McReynolds) said (310 U. S. 434, 464):

"The Act will be searched in vain for any hint of such a distinction (the contention of S.E.C. that Chapter X applies to corporations whose securities are held by the public, while Chapter XI applies to close corporations). Small corporations are permitted to avail themselves of Chapter X if stockholders' or secured creditors' rights are to be affected; large corporations, under the very letter of Chapter XI, may avail themselves of its provisions *if all they desire to do is to extend or accommodate their unsecured indebtedness.* The smallest corporation cannot come in under Chapter XI if it desires what has been traditionally known as a reorganization. *The largest corporation may proceed under Chapter XI if it does not desire a reorganization.*" (Interpolation and emphasis ours.)

† The following paragraph was added to Section 366: "Confirmation of an arrangement shall not be refused solely because the interest of a debtor, or if the debtor is a corporation, the interests of its stockholders or members will be preserved under the arrangement."

Nowhere in the record is there a single suggestion or the slightest intimation of the desire or necessity for adjusting the rights of stockholders nor why any reorganization of the debtor was desirable or necessary. This Court in the *U. S. Realty* case concluded that an arrangement was not possible nor could it be "fair and equitable and in the best interests of unsecured creditors without some readjustment of the rights of stockholders" (*Id.*, p. 453). If Congress saw fit to remove from the purview of a Chapter XI proceeding the necessity for requiring "an adjustment of the rights of stockholders", we submit it does not lie with the Court below to legislate interstitially by reincorporating the "fair and equitable" rule in a Chapter XI proceeding. This is all the more untenable where the creditors indicate a willingness to scale down their claims without any adjustment of the rights of stockholders. Where all that a corporate debtor seeks is a composition of its unsecured debts, Chapter X is unavailing and so held the Circuit Court of Appeals for the First Circuit in *John Hancock Mutual Life Ins. Co. v. Casey et al.*, 141 F. 2d 104, wherein the Court said (p. 107):

> "The defect is more fundamental here, however. *The plan is really not a Chapter X plan at all, because all it proposes is to effect a composition of extension of time, with reference to the unsecured debts*—in other words, an 'arrangement' within the purview of Chapter XI. Proceedings under Chapter X and Chapter XI are evidently mutually exclusive." (Emphasis ours.)

The *Mecca Temple* case* was also relied upon by the Court below as determinative of the issues involved in the present case. In that case the debtor, *a membership corporation*, was obligated in the sum of $1,200,000 principal and interest as a result of a public bond issue in the

* *Mecca Temple of Ancient Arabic Order of Nobles of Mystic Shrine v. Darrock*, 2 Cir., 142 F. 2d 869, certiorari denied 323 U. S. 784.

principal amount of $763,000. It proposed to pay each unsecured bondholder, 1,834 in number and located throughout the country, many of whom were non-members of the debtor, 10% of the principal amount of his outstanding bonds in installments of 1% per year for ten years, without interest. At 142 F. 2d 869, 871, the Court wrote:

> "Of course, there still is no well-defined answer in the borderline cases to the question as to whether a particular type corporation should be permitted to proceed under Chapter XI; but especially persuasive here is the nature of the debtor's financial structure, which is such that if a reorganization under Chapter X is not required, the interests of an objecting creditor like appellant are not likely to be adequately protected. We have seen that the annual income of the debtor is well in excess of $50,000; while disbursements total less than $15,000 (a sum which appellant urges could easily be substantially reduced); and yet there is no explanation of the use to which the balance of the receipts is being put. Some explanation is surely due the creditors before they should be obliged to accept 10 cents on the dollar for their principal and nothing at all for their long overdue interest. Should the plan of arrangement proposed in the petition be confirmed, the debtor would be able to liquidate its indebtedness for $7,630 per year for ten years—a result palpably unjust to the unsecured creditors of a corporation whose income appears to exceed its authorized expenditures by nearly $40,000 yearly. These facts by themselves suggest that the plan merits condemnation under Bankruptcy Act, § 366(2), which states that the court shall confirm an arrangement only if it is convinced that 'it is for the best interests of the creditors'."

In addition to finding the proposed plan "palpably unjust" the Court also followed the *U. S. Realty* case with respect to the "fair and equitable" rule and found a further reason to direct a transfer to Chapter X by applying the rule of the *Boyd* case. There has been nothing to indicate that the proposed arrangement in the present case is unjust or inequitable. The *Mecca Temple* case is, therefore, inapplicable on its facts to the present case and, in

any event, its value as a precedent is, along with the *U. S. Realty* case, seriously affected by the 1952 amendment to the Bankruptcy Act, which deleted the "fair and equitable" requirement.

In the *Transvision* case* a different panel of the Court below, in a substantially similar situation, affirmed an order of the District Court which denied an application by the Securities and Exchange Commission for a dismissal of the Chapter XI proceeding unless amended to a Chapter X proceeding. At 217 F. 2d 243, 247, Judge Medina, speaking for the Court, wrote:

> "The SEC has adduced no information which would tend to indicate that the plan is likely to fail, but has, at most, indicated that there may be some basis for suspecting possible improprieties in past management. Certainly, so ephemeral a suspicion is not an adequate basis upon which to overturn a plan which the District Court, on the facts before it at this time, appears to believe may ultimately be found feasible, and one which, necessarily, would have to be acceptable to at least a majority of the unsecured creditors before being approved."

In the present case there has not been even the slightest intimation of any wrongdoing which would require the investigative features of a Chapter X proceeding.† Moreover, as in the *Transvision* case, the proposed arrangement "may well enure to the ultimate advantage of the petitioner and its stockholders" (217 F. 2d 243, 247). Certainly to have dismissed this proceeding before the plan was found to be unfeasible would appear premature.

*In re Transvision, Inc., 217 F. 2d 243, certiorari denied 348 U. S. 952.

† Indeed, as stated by Judge Galston in his dissenting opinion below, 222 F. 2d 234, 238, redress for any wrong, if such were charged, may be had under the Laws of the State of New York, the domicile of the Debtor Petitioner.

Notwithstanding the economic advantages of permitting the present proceedings to remain in Chapter XI, the decision below directs a transfer to Chapter X. The Court below recognizes that the company's present corporate structure is not overly complicated.* Yet, despite the absence of a need for reorganization, the judgment below directs a transfer of the proceedings to Chapter X, apparently solely on the ground that the debtor is a corporation whose stock is publicly held, which was also the situation in the *Transvision* case.

The Creditors Committee earnestly urges that the Court below in denying the petitioner utilization of Chapter XI was in error. The holding of the Court below that a corporate debtor with publicly held stock may not resort to Chapter XI prevents the debtor from effecting a composition of its unsecured obligations within the Bankruptcy Act, greatly increases the danger of liquidation, and is therefore gravely prejudicial to the best interests of the creditors.

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* See opinion of Clark, C. J., 222 F. 2d 234, 235.

CONCLUSION

For the foregoing reasons, the judgment and order appealed from should be reversed.

Respectfully submitted.

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January 2, 1956.

IN THE

Supreme Court of the United States

October Term 1955

No. 170

GENERAL STORES CORPORATION,
Petitioner,

vs.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS' COMMITTEE AND WAGE CLAIMANTS.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT, MAX SHLENSKY

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT, MAX SHLENSKY

Questions Presented

1. Whether the arrangement procedure of Chapter XI of the Bankruptcy Act is available to a corporate debtor with assets of approximately $5,000,000.00 and liabilities of $4,000,000.00, and whose stock is actively traded on the American Stock Exchange and is held by some 7,000 stockholders, or whether such corporate debtor is restricted to the use of Chapter X.

2. Whether there was a proper exercise of discretion on the part of the District Court in this case in determining that a Chapter XI proceeding instituted by such a corpo-

rate debtor was improper and directing that the Chapter XI petition filed by the corporate debtor be dismissed and that it proceed under Chapter X.

Statement of Case

The debtor is a New York corporation and has outstanding approximately 2,232,000 shares, which are in the hands of some 7,000 stockholders (R. 24a). Of the total amount of outstanding shares of the debtor's stock, about 127,000 shares are owned by directors and officers. The stock is in part registered with the Securities and Exchange Commission and is actively traded on the American Stock Exchange (R. 30a). A considerable portion of the stock of the debtor arises directly out of a prior 77b proceeding initiated by the debtor in 1936. Pursuant to the plan of reorganization, which was consummated as of October 31st, 1940, merchandise claims were satisfied by the issuance of stock (R. 30a). The assets of the debtor are listed at about $5,900,000.00 and its liabilities at about $4,000,000.00. During the past five years the debtor has sustained losses totalling about $4,000,000.00 (R. 32a).

Prior to February 15th, 1954, the debtor was known as D. A. Schulte, Inc. and was engaged in operating an extensive chain of retail tobacco stores. As of July 21st, 1954, the debtor was operating 146 Schulte tobacco stores. At the time of the filing of the petition under Chapter XI, the debtor operated some 76 Schulte tobacco stores (R. 42a). Since the date of the filing of the Chapter XI petition and as debtor-in-possession, it has liquidated all the remaining Schulte tobacco stores (R. 54a).

In August, 1953, the debtor purchased all the outstanding capital stock of Stineway Drug Company, a corporation operating a chain of twenty-three retail stores in the Chicago area. These stores operate fountains and lunch

cosmetics, and sell drugs, cosmetics and kindred items (R. 32a). In addition, Stineway also supplies twelve other stores in the Chicago area, which are identified as Stineway System Stores. The purchase price for the Stineway stock was $1,220,320.50, of which $870,000.00 was paid in cash at the time of closing, and the balance was paid on April 15th, 1954 (R. 32a). A sum aggregating $870,000.00 was borrowed by the debtor from Stineway and was applied toward payment of the balance of the purchase price (R. 32a).

Early in 1954, the debtor purchased all the outstanding capital stock of Ford-Hopkins Company at a purchase price of $2,800,000.00 (R. 33a). Ford Hopkins operates a chain of fifty-three drug stores and three restaurants in the City of Chicago and throughout the Mid-West, and also supplies other stores. A down payment of $735,000.00 was made at the time of the purchase of the Ford Hopkins stock (R. 33a). The balance of $2,065,000.00 was to be paid in installments over a period of years. The down payment of $735,000.00 was paid in part from the proceeds of a $400,000.00 loan from Stineway (R. 33a). To secure payment of the balance all of the stock of Ford Hopkins and Stineway has been transferred to a trustee (R. 33a).

The debtor has thus converted from the direct operation of a chain of tobacco stores to the indirect operation through its subsidiaries of a chain of drug stores and supply houses.

On October 18th, 1954, the debtor filed a petition in the District Court for the Southern District of New York under Section 322 of Chapter XI of the Bankruptcy Act, proposing a plan of arrangement whereby unsecured creditors would receive 100% of their claims, payable in annual installments of 20%.

On November 9th, 1954, Max Shlensky, a stockholder of the debtor, moved by order to show cause, pursuant to

Section 328 for an order dismissing the debtor's Chapter XI petition unless it was amended to comply with the requirements of Chapter X. The Securities and Exchange Commission moved to intervene in the proceedings for the same relief. The District Judge granted the motions of Max Shlensky and the Securities and Exchange Commission. The order entered was affirmed by the Court below.

Summary of Argument

The decision of the Court below is in accord with *Securities and Exchange Commission* v. *U. S. Realty & Improvement Co.* (cited in argument). In that case it was held that the court, in the exercise of sound discretion, had the power to determine the propriety of a Chapter XI proceeding commenced by a corporate debtor, and that such determination would rest upon the size of the corporate debtor and the public holding of its stock.

In 1952 Chapter XI was amended by the addition of Section 328. This statute "codified the law" of the *U. S. Realty* case. It expressly confers upon the Court the power to determine the propriety of a Chapter XI proceeding, at the inception of the proceeding, on the basis of the size and public holding of the stock of a corporate debtor. Deletion of the "fair and equitable" requirement from Section 366 did not limit in any way the basic holding of the *U. S. Realty* case. Chapter XI is designed and intended to afford relief to small corporations in which there is a substantial identity of stock holding with management. Under the circumstances, the "fair and equitable" rule, with the meaning assigned to it in reorganization proceedings, was never intended to apply to Chapter XI proceedings.

The adequacy of relief obtainable by the petitioner under Chapter XI cannot be appraised solely in terms of the

plan of arrangement proposed. It must be appraised in comparison with that to be had under Chapter X. The "summary procedure" of Chapter XI does not afford adequate protection to the public stockholders of the petitioner. Such safeguards can only be found in a Chapter X proceeding. In the case of the petitioner, the major portion of the outstanding stock is held by public stockholders not identified with management interests. The substantial losses sustained by the petitioner and the transactions entered into by petitioner's management to convert the very nature of the business done by the petitioner compels a study and investigation by a disinterested trustee.

The District Court gave proper weight to the criteria fixed in the *U. S. Realty* case in arriving at its determination that petitioner was required to proceed under Chapter X of the Bankruptcy Act.

POINT I

The Court below properly held that the arrangement procedure of Chapter XI of the Bankruptcy Act is not available to the petitioning corporate debtor with assets and liabilities totalling in the millions of dollars and whose stock is actively traded on a National Securities Exchange and is held by some 7,000 stockholders. The petitioner is required to proceed under Chapter X of the Bankruptcy Act.

This case is, in every essential respect, identical with *Securities and Exchange Commission* v. *U. S. Realty & Improvement Co.*, 310 U. S. 434, decided by this Court. They differ only in this regard: in 1952, as a direct result of this Court's *U. S. Realty* decision, Chapter XI of the

Bankruptcy Act was amended.[1] The amendments will be discussed in detail. It is our position that the amendments gave statutory approval to the *U. S. Realty* decision; that the *U. S. Realty* decision continues to be the law governing this case; and that the decision of the Court below constitutes a correct application of that law.

In the *U. S. Realty* case the debtor sought to modify its unsecured obligations on a guarantee of bonds which had been issued by a wholly owned subsidiary. The bonds were then in the hands of some 900 holders. The debtor was a corporation of considerable size with a complicated debt structure and some 7,000 stockholders. The Securities and Exchange Commission moved in the District Court for an order dismissing the Chapter XI petition on the ground that the debtor was required to proceed under Chapter X. In the lower courts the petition of the Securities and Exchange Commission was denied on the ground that the debtor, by filing a petition under Chapter XI proposing a plan of arrangement affecting its unsecured obligations only, had the unqualified right to proceed under that Chapter and the Bankruptcy Court, having obtained jurisdiction, was bound to continue the proceeding.

Reversing the judgment of the lower courts, this Court expressly rejected the interpretation of Chapter XI upon which the lower courts grounded their determination. The right of the debtor to proceed under Chapter XI did not rest solely upon the filing of its petition and the proposal of a plan of arrangement affecting unsecured claims:

> " " " but on considerations growing out of the public policy of the Act found both in its legislative

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1. Section 366 was amended so as to delete therefrom the requirement that a plan be "fair and equitable". Section 328 was added to the Bankruptcy Act, conferring power on the court to direct a transfer of Chapter XI proceedings to Chapter X.

> history and in an analysis of its terms, and of the authority of the court clothed with equity powers and sitting in bankruptcy to give effect to that policy through its power to withhold relief under Chapter XI when relief is available under Chapter X, which is adequate and more consonant with that policy" (p. 448).

Chapters X and XI were compared and analyzed in detail in the light of their legislative history. Freedom to elect to proceed under Chapter XI was not conferred by the Bankruptcy Act upon all corporate debtors regardless of the circumstances. On the contrary, this Court noted that it was the express policy and intent of the Act that:

> "* * * the two chapters were specifically devised to afford different procedures, the one adapted to the reorganization of corporations with complicated debt structures and many stockholders, the other to composition of debts of small individual business and corporations with few stockholders * * *" (p. 447).

Certain criteria for determining the propriety of a Chapter XI proceeding were fixed by this Court. Chief among these are the distribution of the stock of a corporate debtor among public investors as distinguished from management holdings, the size of the corporation defined in terms of assets and liabilities, and the nature of the debt structure. Measured against such standards, the debtor in the *U. S. Realty* case was patently proceeding under the wrong Chapter, as this Court determined. These same standards were applied in *Mecca Temple* v. *Darrock*, 142 F. 2d 869 (C. A. 2d, 1944), where the Court noted:

> "And since the Supreme Court in the United States Realty case, supra, has made an exhaustive

> comparison and analysis of the respective purposes of, and merits of proceedings under, the two chapters, there is little which can be added to the criteria set forth there" (p. 871).

There again the Chapter XI petition was dismissed. Recently, in the case of *In Re Transvision, Inc.*, 217 F. 2d 243 (C.A. 2, 1955); Cert. den., the Lower Court, by another panel, applying the same principles, found the debtor not to be large enough nor the public holdings of its stock so substantial as to compel a transfer to Chapter X and accordingly, the debtor was determined to have proceeded properly under Chapter XI.

The Court below, in the instant case, in arriving at its determination rested entirely on the *U. S. Realty* and *Mecca Temple* decisions, observing (222 F. 2d 234, at p. 236):

> "The criteria for choice between Chapter XI and Chapter X enunciated in that case (U. S. Realty case) were written into the Bankruptcy Act by the enactment of §328, 11 U. S. C. §728, in 1952. See 1952 U. S. Code Cong. & Adm. News 1979-1980. We are content to apply them here." (Matter within parentheses furnished.)

The 1952 Amendatory Acts Amending Section 366 and Adding Section 328, Wrote Into the Bankruptcy Act the Law of the U. S. Realty Case

At the time the *U. S. Realty* case was considered by this Court, Section 366 required that a plan of arrangement be "fair and equitable". This the Court held required that a Chapter XI plan of arrangement be "fair and equitable" within the meaning fixed in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, and *Northern Pacific Ry. Co.*

v. *Boyd*, 228 U. S. 482. According to the fixed "fair and equitable" rule, unsecured creditors were entitled to a priority over stockholders to the full extent of their claims. A plan of arrangement in which these claims were reduced without some fair compensating advantage to the creditors which was prior to the rights of the stockholders, did not meet statutory requirements. Although this rule had initially been applied in relation to reorganization proceedings, it was held equally applicable to Chapter XI proceedings.

Failure on the part of the debtor in the *U. S. Realty* case to comply with the "fair and equitable" doctrine was but another reason for compelling dismissal of its Chapter XI petition. The clear holding of the *U. S. Realty* case is that this very same conclusion would have been reached had this issue not been raised.

The rule that the right of a corporate debtor to proceed initially under Chapter XI is determined by its size and the public holding of its stock is not incident to or an offshoot from the "fair and equitable" rule. The two rules are from different sources, stand independent of each other, and may be considered interrelated only in the sense that they were both applicable to the same pattern of facts. One is derived from the "public policy of the Act" that there is a line of demarcation between Chapters X and XI and that each Chapter was designed and intended to afford relief to different types of corporations. On the other hand, the "fair and equitable" rule was formulated in reorganization cases and was intended to apply to such cases only. But being "words of art", as this Court noted, with fixed and determined meaning, "fair and equitable", when inserted into Section 366 of Chapter XI, were deemed to carry with them such fixed and determined meaning.

This is forcefully illustrated in the *Mecca Temple* case. The basis of that decision was that the debtor, on the

strength of the criteria set forth in the *U. S. Realty* decision, had no right to proceed under Chapter XI. After discussing the *U. S. Realty* decision, and concluding that the criteria as set forth in that decision compelled dismissal of the debtor's Chapter XI petition, the Court observed (p. 872):

> "Yet another reason for reversing the holding below may be found in Bankruptcy Act, section 366(3), which provides that a plan shall not be confirmed unless 'it is fair and equitable' . . ."

When the *U. S. Realty* case was under consideration by this Court, Chapter XI did not contain any provision which, by express statutory language, limited its procedures to certain types of corporations. Nor did it by express language, confer on the court the power to make such determination and to give effect thereto by dismissing the petition. In the absence of such express statutory language, this Court found such limitation on the use of Chapter XI in the "public policy of the Act" and the power of the Court to withhold relief under Chapter XI in the equity powers of the court, sitting as a court of bankruptcy, to give effect to that policy.

This law of the *U. S. Realty* decision was written into statutory law by the Amendatory Acts of 1952 which added Section 328 to Chapter XI.[2] Section 328 expressly grants to the Judge power to dismiss a petition under Chapter XI "if he finds that the proceedings should have been brought under Chapter X of this Act".[3] The purpose of Congress in enacting Section 328 was stated to be:

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2. This was the interpretation given by Judge Clark in the Court below to the amendatory Acts.

3. In the *Mecca Temple* case the court held that the referee had the power to make such determination. But by using the word "judge" instead of the word "court", Section 328 has taken that power out of the hands of the referee.

> "in *Securities and Exchange Commission* v. *U. S. Realty & Improvement Co.*, * * * where a petition was filed under chapter XI by a debtor corporation having hundreds of creditors and thousands of stockholders, it was decided that the court had the duty to dismiss the petition, leaving the corporate debtor to seek relief under chapter X * * *."

and

> "It (Sec. 328) codifies the law of the United States Realty & Improvement case, and adopts the procedure of section 147 for transferring the proceeding to chapter X." (Senate Report No. 1395 on §2234, 82nd Cong. 2nd Sess. (1952) 11; 1952 U. S. Code Cong. & Adm. News 1979-80.)

But the petitioner erroneously argues that a companion amendment deleting the "fair and equitable" requirement from Section 366 constituted a statutory reversal of the *U. S. Realty* decision. It appears to be the petitioner's position that the criteria fixed by this Court resulted only from application of the "fair and equitable" rule. With the elimination of that rule, Petitioner argues, only the plan of arrangement itself may be considered in determining the propriety of a proceeding under Chapter XI. Thus, Petitioner states, Chapter XI is available to all corporations as long as a plan of arrangement is proposed which meets the requirements of that chapter. If this position is properly taken, then in the absence of the "fair and equitable" rule, this court would have come to a contrary conclusion in the *U. S. Realty* case and would have affirmed the holding of the lower courts where the same position was adopted.

To sustain the position of the Petitioner, we are obligated to overlook the clear language of the *U. S. Realty* opinion, to ignore the Congressional report on Section 328, to render entirely ineffectual and meaningless that statute,

and to consider as mere surplusage the Senate and House reports on the amendment to Section 366. In those reports the following observation on the purpose for so amending Section 366 was made:

> "However, the fair and equitable rule cannot be applied in a chapter XI, XII, or XIII proceeding if construed as interpreted in Northern Pacific Railway Co. v. Body (228 U. S. 482, 33 S. Ct. 554, 57 L. Ed. 931 (1913)), and reaffirmed in Case v. Los Angeles Lumber Products Co., Ltd. (308 U. S. 106, 41 Am. B.R. (N.S.) 110, 60 S. Ct. 1, 84 L. Ed. 110 (1939)), without impairing, if not entirely making valueless, the relief provided by these chapters. If so applied, no individual debtor or corporate debtor (where stock ownership is substantially identical with management) under chapter XI, and no individual debtor under chapter XII or XIII can effectuate an arrangement or plan by scaling of debts.
>
> The fair and equitable rule was never applied in a composition proceeding under the former section 12 of the Bankruptcy Act, which has been replaced by chapter XI, nor is it practicable or realistic to apply it in a proceeding under chapter XI, XII, or XIII." (Senate Report No. 1595 on S. 2234, 82nd Cong., 2nd Sess. (1952) 11; 1952 U. S. Cong. and Adm. News, 1981-2).

Since Chapter XI was designed for small corporate debtors which were substantially management owned, it may be said that the "fair and equitable" rule was never intended to be applied with its full impact to the more simple arrangement plans under Chapter XI. It was in

tended to apply only to reorganization proceedings and plans.[4]

Section 328 may only be considered properly with the *U. S. Realty* decision as a framework of reference. It ratifies and expresses the law of that case that it is within the powers and duty of the court to grant or withhold the relief under Chapter XI depending upon the corporate structure of the debtor and its status as a publicly held corporation. Omission to spell out the *U. S. Realty* criteria is without significance. It was sufficient for Congress to confer by express statutory provision such powers on the court in the light of the *U. S. Realty* decision.

Petitioner would have Section 328 invoked only in those instances where the plan of arrangement is itself incapable of confirmation.[5] At the same time Petitioner urges that the plan may only be tested by the requirements of Section 366.[6] Putting aside the requirements of subsections (1), (3) and (4) of that section as being inapplicable to the discussion, we are left merely with the requirement that a plan be in "the best interests of creditors". Yet this requirement is satisfied by a demonstration that the creditor body stands to gain more from the plan of arrangement than from a liquidation of the debtor.[7] Should a contrary finding be made there is nothing to prevent the debtor from proposing another plan, one meeting the objections to the former plan.[8] In this connection it may be noted that

4 It was observed in the *U. S. Realty* case that with respect to small corporations essentially management owned, preservation of going concern value of the debtor through its continued management by stockholder managers would be adequate compensation for the reduction of unsecured claims without alteration of management interests. Although the "fair and equitable" rule no longer applies, Judge Clark applied its "exception" as a test, apparently on the belief that the "exception" expresses the philosophy of Chapter XI.

5 See 8 Collier on Bankruptcy (14th ed.) 1107 et seq.

6 Section 366.

the plan first proposed in the petition is very often not the one confirmed. In many cases the exigencies of the moment demand immediate filing of a Chapter XI petition to maintain the *status quo*. All efforts are bent in the direction of speed. Insufficient time is devoted to the plan itself. The debtor contents itself in the knowledge that at some later time, after a creditors' committee has been formed, it may negotiate with that committee and formulate a plan acceptable to itself and the committee.

Moreover, a Chapter XI plan of arrangement may affect unsecured claims only.[7] A plan which proposes some alteration of rights incident to stock ownership or some readjustment of secured claims is intrinsically defective and is beyond the jurisdiction of the court to consider and confirm. We may assume that in the Petitioner's scheme of things Section 328 would be limited in its application to such plans. In the light of that statute's legislative history, this places an unduly restrictive and narrow interpretation on the statute. For all practical purposes Section 328, if so interpreted, would be consigned to the role of a useless appendage to the Bankruptcy Act.

The Petitioner Cannot Obtain Adequate Relief Under Chapter XI

We agree that if the Petitioner is permitted to proceed under Chapter XI and a plan of arrangement is confirmed, it will achieve some financial relief derived from a scaling down of unsecured debts. But this is not the point. Because of the presence of some 7,000 stockholders, it does not rest with management alone to determine whether the remedies afforded by Chapter XI are adequate. Adequacy of relief in this case is not tested by the plan alone, that is,

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7. Section 360(1). *See In Re Imperial Mines Corp.*, 195 F. 2d 492 (1951).

by what management deems may be beneficial to the Petitioner. As this Court noted in the *U. S. Realty* case:

> "Obviously the adequacy of the relief under Chapter XI must be appraised in comparison with that to be had under Chapter X, and in the light of its effect on all the public and private interests concerned including those of the debtor" (p. 455).

Chapter XI grants a "summary procedure" (*U. S. Realty* case, p. 446) particularly adapted to afford financial relief to small corporate debtors, essentially management-owned. It is a proceeding which, subject to the supervision of the Bankruptcy Court, is management-controlled. In the Southern District of New York the practice is to continue the debtor in possession. As a debtor-in-possession, management continues to direct the affairs of the Petitioner. Controls which are exercised by the Court relate generally to the prevention of undue diminution of assets of the estate, to assure that in the event an order of adjudication in bankruptcy is ultimately entered, the estate will have approximately the same value it had at the time the Chapter XI petition was filed.

We have, in the case of the debtor, a striking example of the control which management exercised over the affairs of a debtor-in-possession during the pendency of a Chapter XI proceeding. At the time the Chapter XI proceeding was instituted, the petitioner was operating a chain of retail tobacco stores. Previously it had embarked upon a program of discontinuing the operation of this type of store. But at the time of the filing of the petition, the Petitioner was still operating 76 retail tobacco stores. As a debtor-in-possession, the Petitioner ceased the operation of all of such stores and was able to complete its conversion to a holding company structure, operating through subsidiaries chains of drug stores. In effect, therefore,

the Petitioner was enabled to effect an informal "reorganization". This was done without the scrutiny of the Securities and Exchange Commission, the only agency capable of protecting the interests of the public stockholders. Consequently, the propriety of the action so taken by the Petitioner did not receive the full attention and consideration required.

Management alone formulated the Petitioner's plan of arrangement. In the event that this plan is not acceptable to the creditors' committee, management alone will negotiate with the creditors' committee to formulate a plan acceptable to both management and the committee. No controls whatsoever are exercised by the Court in this phase of the Chapter XI proceeding.

Petitioner also fallaciously argues that the creditors' committee appointed in the Chapter XI proceeding constitutes a form of safeguard, which renders invoking the provisions of Chapter X unnecessary. Creditors' committees generally consist of trade creditors only. This would certainly hold true in the overwhelming number of Chapter XI cases. We can assume that a number of the members of the committee in this case are creditors whose claims arose out of the operation of the tobacco stores. Whether or not these creditors would continue to have any real further interest in the Petitioner is open to question.

In any event, the creditors' committee does not represent a form of control which is an adequate substitute for the machinery of Chapter X. Too many risks are entailed. It would be necessary to assume, if the Petitioner's argument is accepted, that in all instances the composition of the creditors' committee would be such that the committee would be truly vigilant and fully understanding of all the problems confronting the debtor. As creditors holding trade claims, the members of the committee cannot be expected to demonstrate the necessary consideration for the

welfare of a Chapter XI debtor; their interest is limited to assuring payment in accordance with the plan. Moreover, as trade creditors, the interests of the creditors' committee are truly antithetical to those of the public stockholders.

The debtor's argument that the Plan alone must be considered, and that it may only be tested by the requirement that it be in the "best interest of creditors renders complete exclusion of any consideration of the rights of Public stockholders in the proceeding."[8]

In this case where the public holding of the stock of a debtor is so considerable that management holds but a minor portion of the total outstanding issue of the stock, Chapter XI may be used by management to avoid full disclosure of its responsibility for the condition of the corporation and to perpetuate itself in control. Even though the jurisdiction of the Bankruptcy Court has been invoked, it is without power to aid individual stockholders in the Chapter XI proceeding, who may question management's handling of the affairs of the debtor. Such stockholders would be compelled to look to the State Law and institute proceedings in the State Court.

In the case of the debtor, there have been losses totalling $4,000,000.00 during a period of great prosperity. The business in which the petitioner engaged has been abandoned. Through various arrangements which have been made, petitioner has been converted into a holding corporation. Even here, however, the debtor's position is most precari-

8. Petitioner's arguments lead it into strange areas of self-contradiction. It states that as a result of the amendatory acts, only the plan may be considered and whether such plan is in the best interests of creditors. But petitioner also argues that the clear intent of the amendments was to confer on all stockholders of a debtor the right and opportunity to attain a reduction of unsecured debts without an alteration of their interests.

ous. To secure payment of the balance of $2,650,000.00 remaining unpaid on the purchase of the Ford Hopkins stock the petitioner has transferred to a trustee, as collateral, all the stock of Ford Hopkins and Stineway. These interests have thus been placed in grave jeopardy. None of these matters are subject to the examination of the Bankruptcy Court sitting in a Chapter XI proceeding.

We urge that these matters require detailed examination and investigation. Only through Chapter X can this be accomplished. Chapter X alone provides the necessary machinery to protect "the investing public dissociated from control or active participation in management" who "needs the impartial and expert administrative assistance in the ascertainment of facts, in the detection of fraud, and in the understanding of complex financial problems", *U. S. Realty*, p. 448. This Court summarized the safeguards provided by Chapter X as follows (pp. 448-450):

> "The creation of the Securities and Exchange Commission, specially charged by various statutes with the protection of the interests of the investing public, and observed inadequacies of section 77B, led to its revision and enactment in changed form as Chapter X, so as to provide for a larger measure of control by the court over security holders' committees and the formulation of reorganization plans and to secure impartial and expert administrative assistance in corporate reorganizations through participation of the commission. Except where the liabilities are less than $250,000, Chapter X requires the appointment of a disinterested trustee, §§ 156, 158, and a thorough examination and study by the trustee of the debtor's financial problems and management, § 167(3)(5). The trustee is required to report the result of his study, to send the report to all security holders with notice to submit to him proposals for a plan of reorganization, § 167(5)(6).

He then formulates a plan or reports the reasons why a plan cannot be formulated. § 169. By § 170 consent to a plan in advance of its initial approval by the judge is void unless procured with his consent. A large measure of control is given to the court over the reorganization and of committee of security holders and their compensation. §§ 163, 165, 209, 212, 241-243.

If the judge finds the plan presented worthy of consideration he may refer it to the commission for report and must do so where the liabilities of the debtor, as in the present case, exceed $3,000,000. § 172. When the plan is submitted to creditors after approval by the judge it is accompanied by the report of the commission and the opinion of the judge approving the plan. § 175. The commission with the approval of the court is authorized to participate generally in the proceedings as a party, and it is its duty to do so upon request of the court. § 208.

By comparing its plan of arrangement with the one involved in the *U. S. Realty* case, the debtor seeks to distinguish the *U. S. Realty* case from the instant one. We have previously noted that the petitioner also urged that the decision received statutory reversal in the 1952 Amendatory Act. Petitioners as it will be noted later also urges that the decision was contrary to law. In essence it is the position of the debtor that whereas the *U. S. Realty* plan involved modification of claims in the form of bonds held by the investing public, petitioner's plan, on the other hand, directly affects trade claims only and that accordingly, the interest of the public stockholders is not directly involved. In other words, the petitioner wishes this Court to disregard all of the criteria which it fixed for determining the propriety of a Chapter XI pro-

ceeding and look solely to the plan of arrangement. It is essentially a repetition of the very argument rejected in the *U. S. Realty* case.

The *U. S. Realty* decision is grounded on the broad basis of public policy as expressed in the Bankruptcy Act. It fixed definite limitations on the utilization of Chapter XI. Although this Court was concerned in the *U. S. Realty* case with protecting two classes of public investors, bondholders and stockholders, it is clear that the decision was not based upon the attempted alteration of rights of public bondholders. Rather the decision was based upon the fact that the debtor there was a corporation with assets and liabilities in the millions of dollars and had some 7,000 stockholders. It is reasonably clear that the same result would have been reached by this Court had the plan not encompassed the claims of the public bondholders. The opinion of this Court will be read in vain for any indication that a contrary result would have been reached in the absence of such public bondholders. All the protection afforded under Chapter X, as noted by this Court, were required to protect all public investors, regardless of class or type of investment holding.

Actually, however, when the petitioner compares its plan with the one in the *U. S. Realty* case, it urges that the *U. S. Realty* proceedings were dismissed because the plan could not meet the requirements of the "fair and equitable" rule. It is not, therefore, so much interested in distinguishing the *U. S. Realty* case even on the basis of a comparison of the respective plans as it is in showing, however erroneous, that because the "fair and equitable" rule is no longer a part of Chapter XI, the *U. S. Realty* decision is not applicable to this case.

The argument of the petitioner that no need to invoke the safeguards of Chapter X is evidenced in this case, because the stockholders stand to gain from the scaling

down of trade obligations, is specious. The most that can be said for this argument is that the condition of the petitioner is so grave that any action at all which is taken to prevent its destruction must of necessity inure indirectly to the benefit of stockholders. Any such so-called gain is more theoretical than actual. The Chapter XI proceeding, if permitted to continue, might prove to be merely a "breathing spell". The petitioner has a previous record of serious financial difficulty. Its present condition is grave. No reasonable assurance can be given that the debtor will not find itself back in the hands of the Bankruptcy Court in the near future, even if its plan of arrangement should be confirmed. Sacrifice of all the safeguards of Chapter X is too great a price to be paid for such so-called gain.

We do not urge that the mere presence of a public stockholding body is sufficient to compel a transfer of Chapter XI to one under Chapter X. As it was observed by this Court, there is no:

> "* * * definition or classification which would enable us to say that a corporation is small or large, its security holders few or many, or that its securities are 'held by the public', so as to place the corporation exclusively within the jurisdiction of the court under one chapter rather than the other" (p. 447).

In the *Mecca Temple* case the same observation was made:

> "Of course, there is still no well defined answer in the border line cases to the question as to whether a particular type of corporation should be permitted to proceed under Chapter XI; * * *" (p. 871).

Recently, in the *Transvision* case the Court below was confronted with just such a problem. The debtor in that

case had outstanding 385,000 shares of common stock and 1,773½ shares of preferred stock. All of such stock was held by management interests, except 135,000 shares of common stock which were held by but 435 public investors. The corporation was a comparatively small one, having liabilities of about $700,000.00 and assets of about $1,000,000.00. In that case the Court held that the debtor was properly proceeding under Chapter XI. The mere existence of 435 stockholders holding a minor portion of the stock of the debtor was not sufficient to compel a transfer of the proceeding to Chapter X. But, applying the principle of the *U. S. Realty* decision, the Court observed:

> "In this connection, it may be observed that the more complex the debt structure and diffuse the stock distribution, the greater the likelihood that Chapter XI will not afford adequate protections and the greater the impulsion to relegate the petitioner to the relief afforded him under Chapter X. Securities Commission v. U. S. Realty Co., 1940, 310 U. S. 434, 60 S. Ct. 1044, 84 L. Ed. 1293; Mecca Temple, etc. v. Darrock, 2 Cir., 1944, 142 F. 2d 869" (p. 246).

We do not believe that the *Transvision* case is inconsistent either with the holding in the *U. S. Realty* case or with that of the *Mecca Temple* case. The *Transvision* debtor was neither large enough nor was the public holding of its stock so substantial as to bring it within the holding of the *U. S. Realty* or *Mecca Temple* cases. By referring to the feasibility of the *Transvision* plan, the Court did not depart from the criteria as fixed in the *U. S. Realty* case or in the *Mecca Temple* case. Having concluded that initially the *Transvision* debtor was not required to proceed under Chapter X, the Court then properly addressed itself to the plan of arrangement.

Accordingly, the *Transvision* decision does not represent a departure from the rule of the *U. S. Realty* and *Mecca Temple* cases that determination of the propriety of a Chapter XI proceeding should be made at the beginning of the proceeding.

Patently, the petitioner is not that particular type of corporation which, by reason of its size or diffusion of stock holding, constitutes "a border line case", or one in which it is difficult to determine whether it is large or small or directly held by the public. The facts were so compelling that the Judge in the District Court, upon a comparison of the *Transvision* debtor with the petitioner, directed a transfer of the Chapter XI proceeding to one under Chapter X.

Petitioner rests heavily on Section 146, which provides that a Chapter X petition shall not be deemed to be filed in good faith if adequate relief is obtainable under Chapter XI. Petitioner here argues that it could not in good faith state that adequate relief was not obtainable under Chapter XI. This merely begs the question. A ruling by the Court that the petitioner must proceed under Chapter X is a ruling that Chapter XI does not afford adequate relief to the petitioner. Had the petitioner initially filed a petition under Chapter X, the Court, applying the same rules, would have been constrained to approve the petition on the ground that the petition did comply with the requirements of Section 146.

Dismissal of the Chapter XI Petition in This Case Was a a Proper Exercise of Discretion on the Part of the Courts Below

Determination of the propriety of a Chapter XI proceeding rests with the Court in the exercise of sound discretion. That the Court has this discretionary power was stated in the *U. S. Realty* case:

> "In this situation, we think the court was free to determine whether the relief afforded by Chapter XI was adequate as it would have been if respondent had filed its petition under Chapter X" (p. 456).

But in making such determination the Court is required to apply the criteria set forth in the *U. S. Realty* case. In each case the question turns on whether the Court properly evaluated the debtor in the light of these criteria. Being addressed to the debtor itself, to its size, the nature of its debt structure, and the public holding of stock, rather than to the plan proposed, these criteria require that determination be made by the Court at the beginning of the proceeding. Otherwise, as Judge Clark noted, the real value of such determination is lost. The power to make such determination at the inception is expressly conferred on the Court by Section 328.

The facts in this case are so clear that they compelled dismissal of the Chapter XI petition. As we noted previously, a comparison of the petitioner with the *Transition* debtor rendered it impossible to arrive at any other conclusion. The facts which are material to the determination are: the debtor is a corporation with assets and liabilities running into the millions of dollars; it has some 7,000 stockholders who hold the major part of the stock; it has sustained in the years immediately preceding the filing of the petition losses in the millions of dollars, yet

this was a period of prosperity; management has altered completely the very nature of the business done by the debtor; management has placed the very existence of the debtor in peril by pledging its only assets to secure payment for the Ford Hopkins stock.

These facts underscore the need for a thorough study and investigation by a disinterested trustee. The fact that no actual wrong doing on the part of management has at this time been uncovered is immaterial. In the *Transvision* case this point was important only because the debtor otherwise qualified to proceed under Chapter XI.

As Judge Clark noted:

> "Now the new common (stock) is again partially under water and the stockholders are justifiably concerned, for their interests are in no way protected in a chapter XI proceeding * * *" (p. 236),

and

> "They wish some assurance of a fair plan now before the remaining assets are dissipated" (p. 236).

The argument of petitioner that the *U. S. Realty* decision was contrary to law is without merit. Petitioner here urges that despite the Amendatory Acts of 1952, which expressly wrote into statutory law the holding of the *U. S. Realty* case, this Court should now reverse itself. The *U. S. Realty* case properly expressed the law of Chapter XI and retains all its vigor at this time.

CONCLUSION

The judgment of the Court below should be affirmed.

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APPENDIX

In addition to the Statutes set forth in the appendix to petitioner's brief, the following Statutes are involved:

Sec. 156. Upon the approval of a petition, the judge shall, if the indebtedness of a debtor, liquidated as to amount and not contingent as to liability, is $250,000 or over, appoint one or more trustees. Any trustee appointed under this chapter shall be disinterested and shall have the qualifications prescribed in section 45 of this Act, except that the trustee need not reside or have his office within the district. If such indebtedness is less than $250,000, the judge may appoint one or more such trustees or he may continue the debtor in possession. In any case where a trustee is appointed the judge may, for the purposes specified in section 189 of this Act, appoint as an additional trustee a person who is a director, officer, or employee of the debtor.

Sec. 157. An attorney appointed to represent a trustee under this chapter shall also be a disinterested person: *Provided, however*, That for any specified purposes other than to represent a trustee in conducting the proceeding under this chapter the trustee may, with the approval of the judge, employ an attorney who is not disinterested.

Sec. 158. A person shall not be deemed disinterested, for the purposes of section 156 and section 157 of this Act, if—

(1) he is a creditor or stockholder of the debtor; or

(2) he is or was an underwriter of any of the outstanding securities of the debtor or within five years prior to the date of the filing of the petition was the underwriter of any securities of the debtor; or

(3) he is, or was within two years prior to the date of the filing of the petition, a director, officer, or employee of the debtor or any such underwriter, or an attorney for the debtor or such underwriter; or

(4) it appears that he has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor or such underwriter, or for any reason an interest materially adverse to the interests of any class of creditors or stockholders.

Sec. 163. Upon the approval of a petition, where the debtor is continued in possession, the debtor shall, at the expense of the estate, prepare, make oath to, and file in court, within such time as the court shall fix

(1) a schedule of its property, showing the location, quantity, and money value thereof;

(2) a schedule of its creditors of each class, showing the amounts and character of their claims and securities and, so far as known, the name and post office address or place of business of each creditor; and

(3) a schedule of its stockholders of each class showing the number and kind of shares registered in the name of each stockholder, and the last known post-office address or place of business of each stockholder.

Sec. 165. If in any case it appears that a person, other than the debtor or its trustee, has in his possession or under his control a list of security holders of the debtor or information in respect to their names, addresses, or the securities held by any of them, and such list or information is necessary, in order to disclose the names and addresses of the beneficial owners of such securities, or to prepare or complete the schedules required to be filed under section 163 of this Act or the lists required to be filed under section 164 of this Act, the court shall direct such person, after a hearing upon notice to him, to produce such list or a true and correct copy thereof, or to furnish such information, or to permit the inspection or use thereof, as may be deemed by the court necessary for the foregoing purposes.

Sec. 167. The trustee upon his appointment and qualification—

(3) shall report to the judge any facts ascertained by him pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action available to the estate;

(5) shall, at the earliest date practicable, prepare and submit a brief statement of his investigation of the property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, in such form and manner as the judge may direct, to the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the judge may designate; and

(6) shall give notice to the creditors and stockholders that they may submit to him suggestions for the formulation of a plan, or proposals in the form of plans, within a time therein named.

169. Where a trustee has been appointed the judge shall fix a time within which the trustee shall prepare and file a plan, or a report of his reasons why a plan cannot be effected, and shall fix a subsequent time for a hearing on such plan or report and for the consideration of any objections which may be made or of such amendments of plans as may be proposed by the debtor or by any creditor or stockholder.

172. After the hearing, as provided in section 169 or section 170 of this Act, and before the approval of any plan, as provided in section 174 of this Act, the judge may, if the scheduled indebtedness of the debtor does not exceed $3,000,000, and shall, if such indebtedness exceeds $3,000,000, submit to the Securities and Exchange Commission for examination and report the plan or plans which the judge regards as worthy of consideration. Such report shall be advisory only.

175. Upon the approval of a plan by the judge, the trustee or the debtor in possession shall transmit, by mail or otherwise, to all creditors and stockholders who are affected by any such plan—

(1) the plan or plans so approved, together with a summary thereof approved by the judge;

(2) the opinion of the judge, if any, approving the plan, or plans, or a summary thereof approved by the judge;

(3) the report, if any, filed in the proceeding by the Securities and Exchange Commission, as provided in section 172 of this Act, or a summary thereof prepared by the Securities and Exchange Commission; and

(4) such other matters as the judge may deem necessary or desirable for the information of creditors and stockholders.

Sec. 176. No person shall, without the consent of the court, solicit any acceptance, conditional or unconditional, of any plan, or any authority, conditional or unconditional, to accept any plan, whether by proxy, deposit, power of attorney or otherwise, until after the entry of an order approving such plan and the transmittal thereof to the creditors and stockholders, as provided in section 175 of this Act; and any such authority or acceptance given, procured, or received by reason of a solicitation prior to such approval and transmittal shall be invalid, unless such consent of the court has been so obtained.

Sec. 208. The Securities and Exchange Commission shall, if requested by the judge, and may, upon its own motion if approved by the judge, file a notice of its appearance in a proceeding under this chapter. Upon the filing of such a notice, the Commission shall be deemed to be a party in interest, with the right to be heard on all matters arising in such proceeding, and shall be deemed to have intervened in respect of all matters in such proceeding with the same force and effect as if a petition for that purpose had been allowed by the judge; but the Commission may not appeal or file any petition for appeal in any such proceeding.

Sec. 209. Any creditor or stockholder may in a proceeding under this chapter act in person, by an attorney at law, or by a duly authorized agent or committee.

Sec. 212. The judge may examine and disregard any provisions of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor.

Sec. 241. The judge may allow reimbursement for proper costs and expenses incurred by the petitioning creditors and reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in a proceeding under this chapter—

(1) by a referee;

(2) by a special master;

(3) by the trustee and other officers, and the attorneys for any of them;

(4) by the attorney for the debtor; and

(5) by the attorney for the petitioning creditors.

Such compensation of referees and trustees shall not be governed by sections 40 and 48 of this Act.

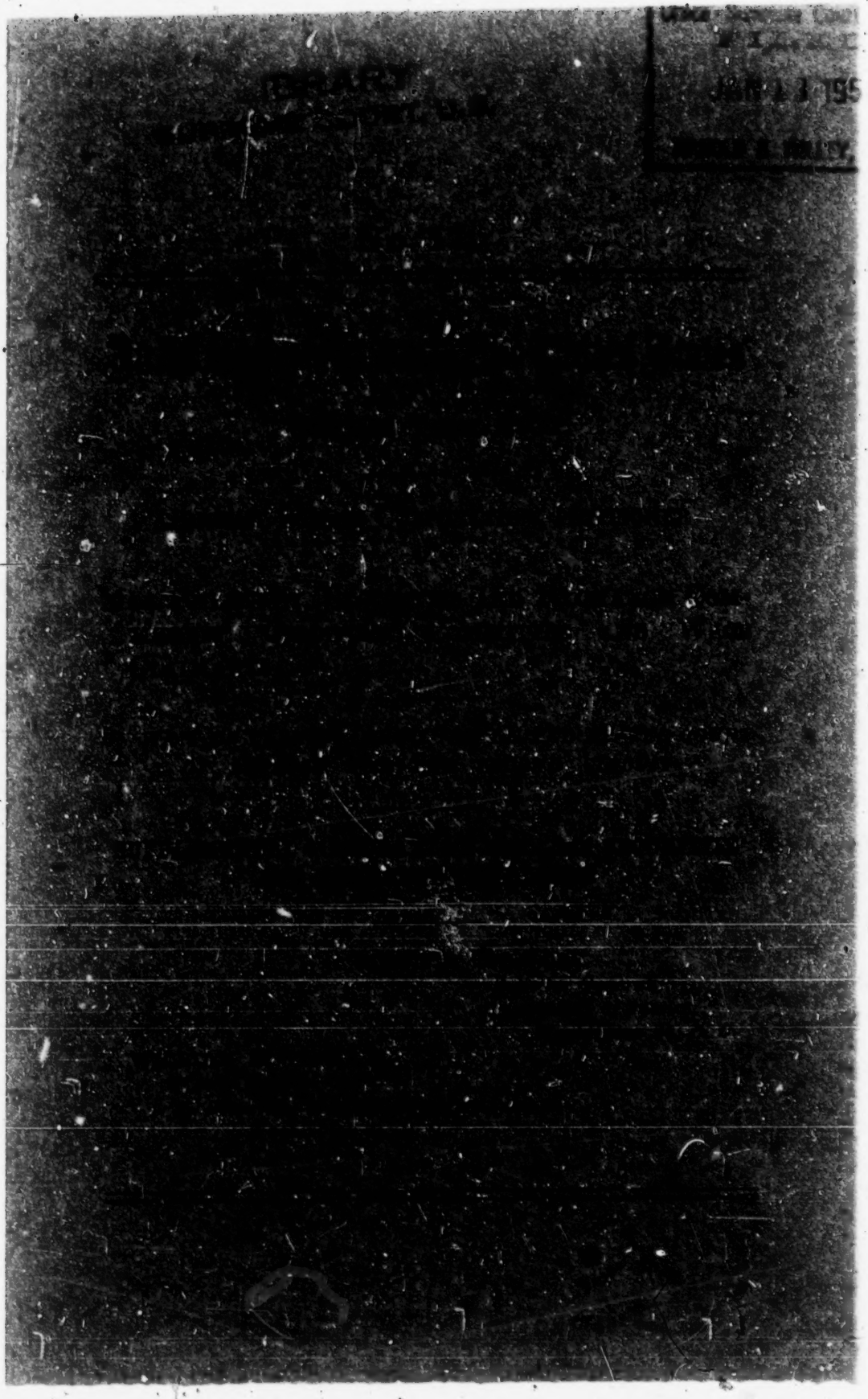
Sec. 242. The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in connection with the administration of an estate in a proceeding under this chapter or in connection with a plan approved by the judge, whether or not accepted by creditors and stockholders or finally confirmed by the judge—

(1) by indenture trustees, depositaries, reorganization managers, and committees or representatives of creditors or stockholders;

(2) by any other parties in interest except the Securities and Exchange Commission; and

(3) by the attorneys or agents for any of the foregoing except the Securities and Exchange Commission.

Sec. 243. The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred by creditors and stockholders, and the attorneys for any of them, in connection with the submission by them of suggestions for a plan or of proposals in the form of plans, or in connection with objections by them to the confirmation of a plan, or in connection with the administration of the estate. In fixing any such allowances, the judge shall give consideration only to the services which contributed to the plan confirmed or to the refusal of confirmation of a plan, or which were beneficial in the administration of the estate, and to the proper costs and expenses incidental thereto.



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In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 170

GENERAL STORES CORPORATION, PETITIONER

v.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS' COMMITTEE AND WAGE CLAIMANTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

Two of the parties to this appeal, the Creditors Committee and the Wage Claimants, although designated respondents, support the petitioner and seek to have the order of the court below reversed. Since we had not received their briefs when our brief was filed, we are filing this supplemental memorandum at this time. As pointed out below, the two briefs to which this memorandum is addressed rely in part on material which is not in the record before this Court.

1. The brief for the Wage Claimants sets forth (p. 2) that there are claims "aggregating approximately $248,000, of which almost $90,000 represent claims entitled to priority under * * * the Bankruptcy Act." The Wage Claimants urge that these substantial claims are jeopardized by the determination of the courts below. We believe that for reasons pointed out in our main brief (pp. 41–42, fn. 23) wage claimants would be treated as well under Chapter X as under Chapter XI.[1] In any event, neither the size nor the respective treatment of wage claimants is a determinative criterion on the question whether a particular debtor may utilize Chapter X or Chapter XI under the rationale of *Securities and Exchange Commission* v. *United States Realty & Improvement Company*, 310 U. S. 434.

The Wage Claimants cite in support of their figures only their unsworn petition, containing no record references, which was filed in support of the debtor's petition for a writ of cer-

[1] We there pointed out that presumably Chapter X courts "give recognition to the priority of wage claims on the basis of equitable principles of distribution, such as the 'six months' rule' applied in equity reorganizations." In that connection we note that the legislative history of Chapter X shows that the reason Section 64 of the Bankruptcy Act was made inapplicable to Chapter X proceedings was to permit the priorities of Chapter X to "be those used in equity receiverships" and to permit the reorganization procedure to "be adapted to varied situations necessitating flexibility." Hearings before a Subcommittee of the Committee on the Judiciary on H. R. 8046, 75th Cong., 2d Sess. (1938), pp. 37, 77.

tiorari. As we noted in our main brief (p. 41, fn. 23), the record indicates (R. 41) that the sum of the wage claims involved is only $440.47. In an effort to discover the basis of the discrepancy between this figure and those contained in the brief for the Wage Claimants, we have inquired of counsel and been advised that the claims referred to, which were not included in the debtor's schedule, are for the most part claims for severance pay. Whether and to what extent such claims would be entitled to priority under Section 64 (*a*) of the Bankruptcy Act, particularly where many of the employees presumably continued to work for the debtor for some time after the filing of the petition, are issues which were not before the courts below and are clearly not before this Court.

2. The brief of the Creditors Committee (pp. 3, 6) refers to and appears to rely heavily upon "a proposal to pay the equivalent of 40% of unsecured creditors' claims in full satisfaction thereof," which, it is stated, a majority of the members of the Creditors Committee have indicated they would favor. The arguments made at pages 37–46 of our main brief are fully applicable, assuming a composition along the lines set forth in the brief of the Creditors Committee might be obtainable. It should be noted that neither the proposal referred to nor the action of the Creditors Committee thereon appears in the record.

The brief of the Creditors Committee (p. 6) also goes outside the record in its argument that the appointment of a trustee "to undertake an examination and investigation of the Petitioner's liabilities, property, management and numerous other matters relevant to the formulation of a plan" is "totally unnecessary, for the Creditors Committee has conducted an extensive examination into the affairs of the petitioner * * *." Whatever investigation may have been made, the *Realty* case made clear that Chapter X alone provides for an impartial investigation by an independent trustee within the framework of the larger objectives of that chapter.[2]

3. The brief of the Creditors Committee (p. 2) also notes that the capital stock of the debtor's two major subsidiaries is pledged to secure the payment of notes which become immediately due and payable "with the consequent right of foreclosure on the collateral" in the event the purchaser files a petition for relief under any chapter of the Bankruptcy Act, and the brief emphasizes that the petitioner has obtained a waiver of

[2] The Commission did not suggest, as the Creditors Committee claims (Br. 5), "that it alone possesses 'adequate means for a disinterested analysis of the debtor's financial condition, the desirability of the continuance of the enterprise as presently constituted or on any other basis' (R. 36a) * * *." The Committee's record reference shows that the Commission contended only that these benefits were obtainable in Chapter X.

this provision which "*does not extend to a Chapter X proceeding.*" The Committee ignores that upon the filing of the Chapter X petition the court has power to restrain the sale of the pledged collateral, at least where, as in this case, the stock of the subsidiaries represents a major portion of the assets of the debtor and its sale would be tantamount to a virtual liquidation of the enterprise. See *Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co.*, 294 U. S. 648, 675–678. Indeed, only Chapter X can deal with the secured claims and the pledged assets and thus adequately provide for a feasible reorganization.

4. Finally, the Creditors Committee relies (Br. 4) upon *John Hancock Mutual Life Insurance Co. v. Casey*, 141 F. 2d 104 (C. A. 1), in support of the proposition that Chapter X is unavailable where all the corporate debtor seeks is a composition of its unsecured debts. In that case, which did not involve public investors, the court dismissed the Chapter X proceeding upon the ground that a reorganization under Chapter X was "either unnecessary or impossible." 141 F. 2d at 108. The reference by the court to the plan filed by the debtor in that case appears to have been made primarily to illustrate that the petition had not been filed in good faith. *Id.* at 107. To the extent that any language in the opinion may be construed to hold that the limited nature

of a plan determines the availability of Chapter X or Chapter XI, we submit that the opinion is in conflict with the rationale of this court in the *Realty* case. See our main brief at pages 21–28.

Respectfully submitted.

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JANUARY 1956.

U. S. GOVERNMENT PRINTING OFFICE 1956